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# LIMITED LIABILITY COMPANIES

A GUIDE TO  
PROMOTERS, DIRECTORS, INVESTORS  
SECRETARIES AND ACCOUNTANTS

BY

ROBERT ASHWORTH

A.C.A., F.S.A.A.

OF THE FIRM OF NEWMAN, OGLE, ASHWORTH AND CO.  
CHARTERED ACCOUNTANTS



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## PREFACE

EARLY in 1923 I delivered a lecture to the Incorporated Accountants' Students' Society of London on the subject of the "Formation of a Public Limited Company." The lecture was so well received that I have been encouraged to write this book using the substance of my lecture as the basis.

It must, however, be understood that this work is not intended to be a textbook on Company Law, neither is it intended to eliminate the use by students of such a textbook. The object of the book is to summarize the proceedings from the pre-natal days of the company until it is a going concern, and to provide a general guide to the subject for the use of directors, accountants, and investors, also a useful means of revision for accountant students who must necessarily give the subject more detailed study.

Only public companies limited by shares formed under the Companies Acts, 1908 to 1917, are dealt with in this book, with special reference to the formation of such a company to take over going concerns involving the issue of capital to the public. The liquidation of a company is only briefly referred to in Chapter I.

The differences in the requirements of the law relating to public and private limited companies have been detailed, and the full text of Table "A" is given as an Appendix, together with the full text of the Report of the Committee upon the amendment of the law under the Companies Acts, 1908 to 1917, which sat under Lord Wrenbury in 1918.

The Companies (Consolidation) Act, 1908, is referred to throughout the book as " the Act " or " the principal Act," and where the term " investor " is used it should be read to include " speculator."

R. A.

SPENCER HOUSE,  
SOUTH PLACE, E.C.2.

# CONTENTS

PREFACE . . . . .	PAGE V
-------------------	-----------

## CHAPTER I

INTRODUCTION TO LIMITED LIABILITY COMPANIES	I
---	---

Definition—Nature of limited liability—Illegal associations—Minimum number of members—Foreign companies—Method of contracting—Taxation—Effect of formation on credit—Limited companies and firms—Privileges of private limited companies—Method of and grounds for winding-up—Removal of defunct companies from register

## CHAPTER II

THE PROMOTER . . . . .	19
------------------------	----

Definition—Duties of promoter—Relation of promoter to company—Preliminary contracts and expenses—The promoter's agents—Promoter's profit—Taxation—Liability of promoter

## CHAPTER III

EXPERT REPORTS . . . . .	28
--------------------------	----

Definition and status of expert—Accountants' report—Estimates of profit—Object of report—Investigation—Profits for prospectus purposes—Turnover—Valuers' reports—Experts' reports and promoter

## CHAPTER IV

CAPITALIZATION OF THE COMPANY . . . . .	38
---	----

Scope of capitalization—Share capital—Form of capital—Preference shares—Ordinary shares—Deferred shares—Co-partnership shares—Conversion of shares into stock—Mode of conversion—Notice to registrar—Differences between stock and shares—Method of fixing dividend on preference shares and interest on loanable capital—Factors to be considered in deciding form of capital—Classification of capital—Reserve capital



## CHAPTER V

## LOANABLE CAPITAL . . . . .

PAGE

57

Power to borrow and pledge property—Borrowing beyond power—Property capable of being pledged—Debentures—Nature of debentures—Debenture stock—Form—Naked Debentures—Floating debentures—Fixed debentures—Trust deeds—Registration of mortgages and charges—Effect of non-registration—Rights of debenture holders—Issue of debentures—Debentures issued as collateral security—Redemption of debentures—Notes

## CHAPTER VI

REGISTRATION ; PROFITS PRIOR TO INCORPORATION  
AND COMMENCEMENT OF BUSINESS . . . . .

83

Matters incidental to registration—Certificate of incorporation—Effect of incorporation—Profits prior to incorporation—Adjustment of taxation between vendors and purchasers—Restrictions on commencement of business—Trading certificate

## CHAPTER VII

## MEMORANDUM AND ARTICLES OF ASSOCIATION . . . . .

90

Memorandum—Name of company—Misleading names—Publicity of name—Alteration of name—Domicile and registered office—Objects of the company—Powers in objects clause—Alteration of objects clause—Limited liability clause—Members' liability—Extension of members' liability—Capital clause—Nominal capital—Variation of capital clause—Increase of nominal capital—Reduction of capital—Procedure—Effect of reduction—Rights of preference and ordinary shareholders on reduction—Consolidation and subdivision of shares ; reorganization of share capital—Sec. 45—Sec. 120—Reconstruction—Dissentients under Sec. 192—Arbitration procedure under Sec. 192—Association clause—Articles of association—Nature of articles—Table "A"—Form and contents of articles—Alteration of articles—Effect of registration of memorandum and articles

## CHAPTER VIII

## DIRECTORS AND OFFICERS OF THE COMPANY . . . . .

122

Directors—Appointment and choice of directors—Guinea pigs—Position of directors—As trustees—As agents—Ratification of directors' acts—Personal liability on contracts—Secret profits—Delegation of authority—Office of profit—Remuneration—Right to remuneration—Apportionment of remuneration—Additional remuneration—Waiver of remuneration—Taxation of remuneration—Qualification shares—Disqualification—Removal and resignation—Liability of directors—Penalties under the Act—Relief from liability—Board meetings—Notice of meetings—Quorum—Minutes—Absence from meetings—Acts of disqualified directors—First board meeting—Publication of directors' names—Checks on directors—Secretary—Auditors—Persons not officers

# CHAPTER IX

## THE BOOKS AND ACCOUNTS OF THE COMPANY . . . . . PAGE 159

Secretarial books—Compulsory—Optional—Register of members and share ledger—Register of directors and managers—Register of mortgages and charges—Minute books—Annual list and summary—Statement in form of balance sheet—Register of transfers—Seal Book—Directors' attendance book—Application and allotment sheets or book—Shareholders' cash book—Share certificate book—Notice of transfers lodged book—Transfer receipt book—Balance ticket or receipt book—Financial books—Balance sheets and accounts—Holding companies

# CHAPTER X

## PUBLIC ISSUE OF CAPITAL . . . . . 192

Preliminary work—Underwriting—Nature of underwriting contract—Over-riding—Sub-underwriting—Form of underwriting contract—Conditions precedent to payment of underwriting commission—Prospectus—Nature and definition of prospectus—Bill dealing with offers for sale—Contents of prospectus—Information to be disclosed under Sec. 81—Waiver of provisions of Sec. 81—Effect of non-compliance with Sec. 81—Other information in prospectus—Misrepresentation—Liability under Sec. 84—Issue of prospectus—Dating and signing—Filing—Arrangements for advertising and despatching—Abridged prospectus—Arrangements with bankers—Hints on reading the prospectus—Application and allotment—Over-subscription—Under-subscription

# CHAPTER XI

## MEMBERS AND THEIR RIGHTS AND LIABILITIES . . . . . 247

Constitution of membership—Transmission of shares—Who may become members—Share or stock certificates—Effect of certificates—Transfer of shares—Forged transfers—Certification of transfers—Registration—Mortgage of shares—Forfeiture of shares—Surrender of shares—Lien on shares—Calls—Dividends—Profits for dividend purposes—Dividend Warrants—Sec. 33, Finance Act, 1924—Bonus shares

# CHAPTER XII

## MEETINGS OF SHAREHOLDERS AND THEIR RIGHT TO REQUIRE INVESTIGATIONS . . . . . 298

Classification of meetings—Statutory meeting and report—Annual general meetings—Extraordinary general meetings—Special meetings—Convening and notice of meetings—Conduct of meetings—Quorum—Chairman—Voting by show of hands—Proxies—Poll—Ordinary, extraordinary, special, and other resolutions—Right of shareholders to investigate the affairs of the company—Investigation by Board of Trade—Investigation by inspectors appointed by shareholders

## CHAPTER XIII

	PAGE
THE STOCK EXCHANGE IN RELATION TO THE COMPANY AND THE INVESTOR . . . . .	325
Constitution of Stock Exchange—The Stock Exchange and the company—Rigging of markets—The Stock Exchange and the investor—Method of dealing—Brokers' commissions— Rules of the Stock Exchange—Permission to deal—Official quotations	

## APPENDIX A

TABLE "A" OF THE COMPANIES (CONSOLIDATION) ACT, 1908 . . . . .	347
---	-----

## APPENDIX B

REPORT OF LORD WRENBURY'S COMMITTEE, 1918	362
INDEX . . . . .	387

## INSETS

	RET. PP.
FORM OF SHARE CERTIFICATE . . . . .	178-9
FORM OF SHARE WARRANT . . . . .	260-1
COMMON FORM OF SHARE TRANSFER . . . . .	264-5

# LIMITED LIABILITY COMPANIES

## CHAPTER I

### INTRODUCTION TO LIMITED LIABILITY COMPANIES

THE history of limited companies has been so well dealt with by the various authors of textbooks on the subject of Company Law that it is deemed unnecessary to go into the subject in this work. It is sufficient to state that the Companies (Consolidation) Act, 1908, repealed and re-enacted a series of Companies Acts dating from 1862 to 1907, and is now the Act governing all companies registered under it, but it has itself been added to by the provisions of the Companies Acts, 1913 and 1917, and the whole are now referred to as the Companies Acts, 1908 to 1917.

### **Definition of Limited Company.**

A limited company has been well defined as "a legal entity endowed with perpetual succession, capable of holding property in its own right, of incurring debts, and of suing and being sued as a distinct person."

A public limited company is not defined in the Companies Acts, but it may be said to be one which does not come within the definition of a private limited company as defined by Sec. 121 of the principal Act and modified by Sec. 1 of the Companies Act, 1913; that is to say, a private limited company is defined as one which by its articles—

(a) Restricts the right to transfer its shares; and

(b) Limits the number of its members to fifty (exclusive of persons who are in the employment of the company and all persons who, having been formerly in the employment of the company, were while in such employment and have continued after the determination of such employment to be members of the company); and

(c) Prohibits any invitation to the public to subscribe for shares or debentures in the company.

Any company not satisfying these provisions is therefore a public limited company, and must comply with the provisions of the Companies Acts relating thereto.

### **The Nature of the Limited Liability.**

The liability of members of companies formed under the Act may be limited by shares, by guarantee, or partly by shares and partly by guarantee, or may be unlimited.

It is only proposed to deal in this book with a public company having the liability of its members limited by shares.

Companies may, of course, be formed by Royal Charter or under Special Acts of Parliament with limited liability, as for example railway companies, in which case the liability of the members will be limited as provided for in such Charter or Special Act.

The liability of a note-issuing bank cannot be limited with respect to the note issue.

### **Illegal Associations.**

It is provided in Sec. 1 of the Act that not more than ten persons may be in partnership for the purpose of carrying on the business of banking, nor more than

twenty persons for carrying on any other business, unless the association is registered under the Companies Acts, 1908 to 1917, or is formed under some other Act of Parliament, or by Letters Patent, or is one which comes within the Stannaries.

If such an association is formed without registration it is an illegal association, and it cannot, therefore, enforce contracts entered into by it, but every member is personally liable for debts incurred by such Association.

The Trades Union Act of 1871 precludes trade unions from registering under the Act.

### **Minimum Number of Members.**

A public limited company must have at least seven members, but may, within the limit of its authorized capital, have as many more as it desires.

The number of members in a private limited company is restricted, as already shown, and in this case the minimum number of members is fixed at two.

Care must be taken to prevent the number of members falling below the minimum, as Sec. 115 of the Act provides that if the number of members falls below two in the case of a private company or seven in the case of a public company, and it carries on business for more than six months while the number of members is so reduced, every person who is a member of the company after the expiration of that six months and who is cognisant that the company is carrying on business with less than the minimum number of members shall be severally liable for the debts of the company contracted after the expiration of the six months' grace.

A reduction of the number of the members below the minimum is also one of the grounds for winding up the company.

## Foreign Companies Trading in United Kingdom.

Companies registered outside the United Kingdom establishing a place of business within the United Kingdom must conform to the provisions of Sec. 274 of the Act if they wish to enjoy the privilege of limited liability under the Companies Acts. The provisions of this section of the Act are as follows—

274.—(1) Every company incorporated outside the United Kingdom which establishes a place of business within the United Kingdom shall within one month from the establishment of the place of business file with the Registrar of Companies—

(a) A certified copy of the charter, statutes, or memorandum and articles of the company, or other instrument constituting or defining the constitution of the company, and, if the instrument is not written in the English language, a certified translation thereof ;

(b) A list of the directors of the company ;

(c) The names and address of some one or more persons resident in the United Kingdom authorized to accept on behalf of the company service of process and any notices required to be served on the company ; and in the event of any alteration being made in any such instrument or in the directors or in the name of any such persons aforesaid, the company shall within the prescribed time file with the registrar a notice of the alteration.

(2) Any process or notice required to be served on the company shall be sufficiently served if addressed to any person whose name has been so filed as aforesaid and left at or sent by post to the address which has been so filed.

(3) Every company to which this section applies shall in every year file with the registrar such a statement in the form of a balance sheet as would, if it were a company formed and registered under the Act and having a share capital, be required under this Act to be included in the annual summary.

(4) Every company to which this section applies and which uses the word " Limited " as part of its name shall—

(a) In every prospectus inviting subscriptions for its shares or debentures in the United Kingdom state the country in which the company is incorporated ; and

(b) Conspicuously exhibit on every place where it carries on business in the United Kingdom the name of the company and the country in which the company is incorporated ; and

(c) Have the name of the company and of the country in

which the company is incorporated mentioned in legible characters on all billheads and letter paper, and in all notices, advertisements, and other official publications of the company.

(5) If any company to which this section applies fails to comply with any of the requirements, the company, and every officer or agent of the company, shall be liable to a fine not exceeding fifty pounds, or, in the case of a continuing offence, five pounds for every day during which default continues.

(6) For the purposes of this section—

The expression "certified" means certified in the prescribed manner to be a true copy or a correct translation ;

The expression "place of business" includes a share transfer or share registration office.

The expression "director" includes any person occupying the position of director, by whatever name called ; and

The expression "prospectus" means any prospectus, notice, circular, advertisement, or other invitation offering to the public for subscription or purchase any shares or debentures of the company.

(7) There shall be paid to the registrar for registering any document required by this section to be filed with him a fee of five shillings or such smaller fee as may be prescribed.

## Method of Entering into Contracts.

A limited company, being a person distinct from its members, signifying its assent by the use of a Common Seal, enters into contracts in the manner laid down in Sec. 67 of the Act ; that is to say it contracts as an ordinary individual, with this difference, that owing to its artificial nature, it must necessarily act entirely through agents.

It is provided in Sec. 67 of the Act that—

(1) Where the law requires a contract entered into between private persons to be in writing or writing under seal then it may be made on behalf of the company in writing under the common seal of the company, and may in the same manner be varied or discharged.

(2) Any contract which if made between private persons would be required to be entered into in writing and signed by the person to be charged may be made on behalf of the company in writing signed by any person acting under its authority, express or implied, and may in the same manner be varied or discharged.



(3) Any contract which if made between private persons would be valid in law if made verbally may be so made on behalf of the company by any person acting under its authority express or implied and may be varied or discharged in like manner.

It will thus be seen that a limited company has the same contractual powers as an individual or firm, such powers only being restricted by the scope of the Memorandum and Articles of Association of the company.

A limited company is also subject to the ordinary mercantile laws of the realm as an individual, and in particular, the application of the laws of contract and agency solves many of the problems which frequently arise in the conduct of the business of such a company.

### **Taxation of Limited Companies.**

A limited company is liable to pay income tax on its profits at the full standard rate, but may deduct the tax at the same rate from dividends paid to its members and must so deduct tax unless the dividend is declared "free of tax" which in effect amounts to payment of a higher dividend less the tax. In both cases the shareholder must add the tax to the dividend received for the purpose of his own personal return. The amount to be added to the dividend received where tax is deducted at the rate of 4s. 6d. in £ is  $\frac{3}{8}$  of such net dividend, arrived at thus: rate of tax  $\div$  ( $\frac{1}{10}$  - rate of tax).

Companies may not deduct from dividends more tax than they have paid. Shareholders therefore must be given the full benefit, derived by the company, of any dominion tax relief when tax is deducted, and the Finance Act, 1924, makes it compulsory as from the 30th November, 1924, for companies to show clearly on all dividend warrants the actual amount of tax deducted as well as the rate of such tax.

The rate relief, earned income allowance, and personal

allowances made to individuals are not available to limited companies. Directors and employees are, however, entitled to these allowances from their respective fees and remuneration, and shareholders may claim back from the Inland Revenue any tax deducted from dividends in excess of their liability.

Companies are not assessable to super-tax, as individuals are; although until recently they were subject to Corporation Profits Tax which was intended to be a substitution for super-tax. Corporation Profits Tax was, however, abolished by Sec. 34 of the Finance Act, 1924, which provides—

34.—(1) Corporation Profits Tax shall not be charged on profits arising in an accounting period commencing after the thirtieth day of June, nineteen hundred and twenty-four.

Any company which withholds the distribution of its income with a view to the avoidance of the payment of super-tax by the persons entitled to such income may become liable itself to the payment of super-tax under Sec. 21 of the Finance Act, 1922. The companies affected by this section are those—

(a) registered under the Companies Acts, 1908 to 1917, since the 5th April, 1914; and

(b) in which the number of members is not more than fifty, excluding any shareholder who is a trustee or nominee for some person otherwise owning or beneficially interested in shares in the company, or who is an employee of the company, or is the wife or unmarried infant child of a beneficial owner of shares in the company; and

(c) which has not issued any of its shares as a result of a public invitation to subscribe for shares; and

(d) which is under the control of not more than five persons. A company is deemed to be under the control of any persons where the majority of the voting power or shares is in the hands of those persons or

relatives or nominees of those persons, or where the control is by any other means whatever in the hands of those persons.

It will be seen that these provisions aim, in the main, at private limited companies, but are not, of course, confined to them.

Income tax is payable by limited companies in one amount and not in two instalments, as in the case of individuals and firms.

### **Effect on Credit by the Formation of a Business into a Limited Liability Company.**

Many business people, even in these times, hesitate to form their business into a limited company on the ground that such a procedure would adversely affect the credit of the business. This fallacious idea no doubt springs from the fact that there were and still are certain unscrupulous persons who, finding themselves in difficulty with their business, convert it into a limited company in an endeavour to obtain an advantage over their creditors and escape the consequences of being unable to meet their liabilities. The usual method adopted by such persons is to sell their business to a limited company, formed for the purpose, for a consideration, in the main, composed of mortgage debentures, and thus endeavour to obtain preferment, as to return of the capital sunk in the business, over their own unsecured creditors. The cases of *in re Hirth*, 1899, *in re Slobodinsky*, 1903, *in re Goldberg*, 1912, and *re Dombrowski*, 1923, which labelled such attempts as fraudulent conveyances, put a salutary check on the number of such cases as the insolvent debtor was placed in the same position as he was in before the conveyance. Sec. 212 of the Act also places a check upon such persons where a floating charge is given in the debenture.

Far from adversely affecting the credit of the business, the formation of the business into a limited company should strengthen the same, if the business is a sound one, by reason of the information placed at the disposal of creditors and potential customers on the files at Somerset House ; if the business is unsound the damage to credit will, as a rule, have been done before the company can be formed.

### **Difference Between Limited Companies and Firms.**

The following are the main differences between limited companies and partnerships—

(1) A limited company is entirely separate and distinct from its members.

A firm has no such separate entity in English law, and cannot be separated from the individuals who compose it. Actions may, however, for convenience sake, be brought against the partners in the firm name, but discovery of the partners may be ordered at any time during the proceedings.

In Scotland a firm is a legal entity.

(2) A shareholder is not an agent for the company, nor can he bind the company in any way.

A partner is an agent of the firm to do all such acts as lie within the scope of his apparent authority.

(3) The liability of a shareholder is limited to the amount he has agreed to subscribe and which remains unpaid. The liability of directors may, however, be made unlimited by the regulations of the company as originally framed or as altered by Special Resolution, but this unlimited liability ceases one year after they cease to be directors.

The liability of the partners in a firm is unlimited except in the case of a limited partner under the Limited Partnership Act, 1907, and even in this case

there must be one or more general partners whose liability is unlimited.

(4) A limited company is governed by the Companies Acts, 1908 to 1917, and its Memorandum and Articles are subject to those statutes.

A firm is only governed by the Partnership Act, 1890, in the absence of any agreement between the partners.

(5) Subject to the Articles of the company a shareholder may freely transfer his shares. In fact he has a common law right to do so. The right to transfer shares in a private limited company is, however, restricted, as already stated.

One partner in a firm cannot transfer his share in the partnership without the consent of the other partners.

(6) A shareholder in a limited company has only such right to inspect the books of the company as the Act or the regulations of the company give him.

A partner may by himself or his agent inspect the books of the firm at any time.

A limited company may, however, be in partnership with a firm or another limited company.

### **Privileges Extended under the Acts to Private Limited Companies.**

The following are the special provisions of the Act relating to private limited companies—

(1) Sec. 2 provides that a private company may consist of two members instead of seven as in the case of a public limited company, and Sec. 115 provides that it may carry on business so long as the number of members does not sink below two.

(2) Sec. 26 provides that the annual summary need not contain a statement in the form of a balance sheet.

(3) The statutory report required under Sec. 65 need not be sent to shareholders in a private limited

company, but the Statutory Meeting provided for under this section must be held. (*Gardner v. Iredale*, 1912.)

(4) Sec. 72 provides that directors of a private company need not file a consent to act or sign the memorandum for or a contract to take their qualification shares required in the case of a public company.

(5) Under Sec. 82 a statement in lieu of prospectus need not be filed by a private company.

(6) The restrictions as to minimum subscription and allotment imposed on public companies by Sec. 85 of the Act do not apply to private companies.

(7) A private limited company may commence business as soon as it is incorporated, as the restrictions imposed by Sec. 87 of the Act do not apply to it.

(8) Preference shareholders and debenture holders in a private company have no right, under Sec. 114 of the Act, to receive and inspect balance sheets and reports of the company.

A private company will lose all the above privileges and exemptions if it fails to comply with the terms of its Articles and Sec. 1 of the Companies Act, 1913, which requires private companies to file with the annual list and summary the following certificates signed by a director or the secretary—

I certify that the company has not since the date of the last return (or in the case of a first return since the date of the incorporation of the company) issued any invitation to the public to subscribe for any shares or debentures of the company.

*Signature* .....

*Description*.....

Where the list of members shows that the number exceeds fifty—

I certify that the excess of members of the company above fifty consists wholly of persons who are in the

employment of the company and/or of persons who, having been formerly in the employment of the company, were while in such employment, and have continued after the determination of such employment, to be members of the company.

*Signature*.....

*Description*.....

### **Methods of and Grounds for Winding-up a Company.**

MODE OF WINDING-UP. A company may be wound up in one of the three following ways—

- (1) Compulsorily by the Court ; or
- (2) Voluntarily ; or
- (3) Voluntarily under the supervision of the Court.

In all cases a liquidator or liquidators will be appointed to realize the property of the company. The assets must be applied by them in the payment of creditors in their proper order, viz.—

(1) Secured creditors out of the proceeds of their security. A floating charge is, however, subject to payment of the preferential creditors stated below.

(2) Costs of liquidation in their proper order.

(3) Preferential creditors under Sec. 209 of the Act, viz.—

(a) All parochial or other local rates due from the company at the date hereinafter mentioned, and having become due and payable within twelve months next before that date, and all assessed taxes, land tax, property or income tax assessed on the company up to the 5th day of April next before that date, and not exceeding in the whole one year's assessment ;

(b) All wages or salary of any clerk or servant in respect of services rendered to the company during four months before the said date, not exceeding fifty pounds ; and

(c) All wages of any workman or labourer not exceeding twenty-five pounds, whether payable for time or for piece work, in respect of services rendered to the company during two months before the said date : Provided that where any labourer in husbandry has entered into a contract for the payment of a portion of his wages in a lump sum at the end of the year of hiring, he shall have priority in respect of the whole of such sum, or a part thereof, as the court may decide to be due under the contract, proportionate to the time of service up to the said date ; and

(d) Unless the company is being wound up voluntarily merely for the purposes of reconstruction or of amalgamation with another company, all amounts due in respect of compensation under the Workmen's Compensation Act, 1906 (as amended by the Workmen's Compensation Act, 1923), the liability wherefor accrued before the said date, subject nevertheless to the provisions of Sec. 5 of that Act, as amended by the first schedule to the later Act.

(e) Employers' contribution under the Insurance Act, 1911, for a period not exceeding four months prior to winding-up order.

These preferential debts rank equally among themselves, and must either be paid in full or, in the case of insufficient assets to meet them, abate in equal proportions.

If the landlord or other person distrains on the goods or effects of the company within three months next before the date of the winding-up order, the preferential debts have a first charge on the proceeds of such distraint, but the landlord or other person will be subrogated to the rights of the preferential creditors he pays off.

The date to which this section refers is the date of the winding-up order in the case of a company



being wound up compulsorily, and the date of the commencement of the winding-up in any other case.

(4) Creditors for interest.

Any balance remaining must then be distributed amongst the contributories according to their rights and interests under the regulations of the company.

WHO MAY PETITION. The following may petition for the compulsory winding-up of the company—

(1) The company itself may by special resolution so resolve.

(2) One or more contributories.

In this case there must be no calls in arrear and the shares must have been held by the petitioner for at least six months out of the previous eighteen months unless—

(a) He is an original allottee ; or

(b) The shares have devolved upon him by the death of the former owner ; or

(c) He holds them by right of his wife ; or

(d) The number of members of the company has sunk below the statutory minimum.

(3) One or more creditors, who must show that the company is insolvent and unable to pay its debts, or that it is otherwise just and equitable that the company should be wound up.

GROUND FOR WINDING-UP. The grounds for compulsorily winding-up a limited company are—

(1) For any reason whatsoever when the company in general meeting has passed a special resolution that it shall be so wound up.

(2) If the company does not commence business within one year or ceases to carry on business for one year.

(3) If the number of members sinks below the

statutory minimum of seven in the case of a public company and two in the case of a private company.

(4) If the company is unable to pay its debts. A company is deemed to be unable to pay its debts—

(a) If a creditor for a sum exceeding £50 then due has served on the company at its registered office a written notice requiring payment, and the company has for three weeks thereafter neglected to pay the sum or compound or secure it to the reasonable satisfaction of the creditor ; or

(b) Execution, in England or Ireland, issued on a judgment decree in favour of a creditor is returned unsatisfied in whole or part.

(5) Neglect to hold the statutory meeting or send out the statutory report required under Sec. 65 of the Act.

(6) If the Court considers it just and equitable that the company should be wound up.

**WINDING-UP VOLUNTARILY.** A company may be wound up voluntarily in accordance with Sec. 182 of the Act when—

(1) The period fixed by the Memorandum expires or an event has happened upon the happening of which the regulations of the company provide that the company is to be wound up and the company has passed an ordinary resolution to wind up ; or

(2) The company has, for any cause, passed a special resolution to wind up voluntarily ; or

(3) The company has passed an extraordinary resolution that it cannot by reason of its liabilities carry on its business, and that it is expedient that the company be wound up.

**EFFECT OF VOLUNTARY WINDING-UP.** The effect of voluntary winding-up is that—

(1) The company ceases to carry on its business except for the purpose of beneficial winding-up ;

(2) Transfers of shares, unless sanctioned by the liquidator, are void;

(3) The corporate state and powers of the company continue until it is dissolved;

(4) The powers of the directors cease on the appointment of a liquidator, except in so far as the company in general meeting or the liquidator sanctions their continuance.

COURTS HAVING JURISDICTION. The Court in which proceedings should be taken is—

(1) The High Court, if the registered office of the company is in the London Bankruptcy District.

(2) The High Court, or the Court of the County Palatine having jurisdiction, if the registered office is outside the London Bankruptcy District, and the paid-up capital exceeds £10,000.

(3) The County Court of the district having bankruptcy jurisdiction if the paid-up capital does not exceed £10,000.

DATE COMPANY CEASES TO EXIST. The company ceases to exist—

(1) In compulsory liquidation at the date when the order for dissolution is notified to the Registrar of Joint Stock Companies.

(2) In voluntary liquidation three months after notice of final meeting has been sent to the Registrar of Joint Stock Companies, subject to all balances having been paid into the companies liquidation account kept at the Bank of England. In this case the Court may, on proper application being made, extend the period of three months or may re-open the liquidation within two years of dissolution.

(3) In voluntary liquidation under the supervision of the Court, at the date when the Court makes the order for dissolution subject to payment of balances into the companies liquidation account.

## Removal of Defunct Companies from the Register.

Sec. 242 of the Act provides for the removal of the names of companies from the register by the Registrar of Companies in certain cases. The provisions of this section of the Act are self-explanatory, and are as follows—

242.—(1) Where the Registrar of Companies has reasonable cause to believe that a company is not carrying on business or in operation, he shall send to the company by post a letter inquiring whether the company is carrying on business or in operation.

(2) If the Registrar does not within one month of sending the letter receive any answer thereto, he shall within fourteen days after the expiration of the month send to the company by post a registered letter referring to the first letter, and stating that no answer thereto has been received, and that if an answer is not received to the second letter within one month from the date thereof, a notice will be published in the *Gazette* with a view to striking the name of the company off the register.

(3) If the Registrar either receives an answer from the company to the effect that it is not carrying on business or in operation, or does not within one month after sending the second letter receive any answer, he may publish in the *Gazette*, and send to the company by post, a notice that at the expiration of three months from the date of that notice the name of the company mentioned therein will, unless cause is shown to the contrary, be struck off the register, and the company will be dissolved.

(4) If, in any case where a company is being wound up, the Registrar has reasonable cause to believe either that no liquidator is acting, or that the affairs of the company are fully wound up, and the returns required to be made by the liquidator have not been made for a period of six consecutive months after notice by the Registrar demanding the returns has been sent by post to the company, or to the liquidator at his last known place of business, the Registrar may publish in the *Gazette* and send to the company a like notice as is provided in the last preceding subsection.

(5) At the expiration of the time mentioned in the notice the Registrar may, unless cause to the contrary is previously shown by the company, strike its name off the register, and shall publish notice thereof in the *Gazette*, and on the publication in the *Gazette* of this notice the company shall be dissolved : Provided that the liability (if any) of every director, managing

officer, and member of the company shall continue and may be enforced as if the company had not been dissolved.

(6) If a company or any member or creditor thereof feels aggrieved by the company having been struck off the register, the court on the application of the company or member or creditor may, if satisfied that the company was at the time of the striking off carrying on business or in operation, or otherwise that it is just that the company be restored to the register, order the name of the company to be restored to the register, and thereupon the company shall be deemed to have continued in existence as if its name had not been struck off; and the court may by the order give such directions and make such provisions as seem just for placing the company and all other persons in the same position as nearly as may be as if the name of the company had not been struck off.

(7) A letter or notice under this section may be addressed to the company at its registered office, or, if no office has been registered, to the care of some director or officer of the company, or, if there is no director or officer of the company whose name and address are known to the Registrar of Companies, may be sent to each of the persons who subscribed the Memorandum, addressed to him at the address mentioned in the Memorandum.

The provisions of this section must be carefully remembered as companies sometimes continue trading although their names have been expunged from the register in accordance with its provisions, and members have subsequently found that they are, in consequence, saddled with unlimited liability. It is therefore advisable to reply promptly to any communication from the Registrar and to file the requisite returns and notice of any change in the address of the registered office, in order to avoid the possibility of having the name of the company struck off the register at Somerset House.

## CHAPTER II

### THE PROMOTER

THE prime mover in the formation of a public limited company is the much abused promoter, who may be an individual, firm, or syndicate. A syndicate is a limited company, usually a private limited company, formed for the specific purpose of promoting another company or companies.

#### **Definition of Promoter.**

The courts, as a rule, in cases dealing with promoters refuse to define the term "promoter," which is not a legal term but a term of business convenience used to describe the person or persons who "undertake to form a company with reference to a given object, and to set it going, and who take the necessary steps to accomplish that purpose." (*Twycross v. Grant*, 1877.)

It is often a difficult matter to decide who the promoter is, as persons apparently acting as promoters may be merely agents for one who prefers to hide his identity. The best way of finding out who the promoter really is would be to obtain answers to the following questions—

- (1) Who created the idea of forming the company with the stated objects?
- (2) Who gave the necessary instructions to the solicitors to prepare the Memorandum and Articles of Association, and settled the scope thereof?
- (3) On whom rests the liability for the payment of the preliminary expenses?
- (4) Who obtained the appointment of the first directors, solicitors, bankers, brokers, and auditors?
- (5) To whom is the promotion profit payable?

An answer to these questions should reveal the

identity of the promoter, although it must be remembered he may possibly have done all or any of these things through agents. It must certainly not be assumed that the vendors to the company are the promoters, for they have probably only agreed to sell their property if a company is formed to acquire it. The vendors do, however, often act as promoters; especially is this so in cases of amalgamations and reconstructions under Sec. 192 of the Act.

For the purposes of Sec. 84 of the Act, which deals with mis-statements in the prospectus, the expression "promoter" means a promoter who was a party to the preparation of the prospectus or of the portion thereof containing the untrue statement, but does not include any person by reason of his acting in a professional capacity for persons engaged in procuring the formation of the company such as the solicitors, accountants, brokers, or bankers, who merely act as the agents of the promoter.

A Bill is now before Parliament under the short title of the Companies (Offers for Sale) Act, 1924, which proposes by Sec. 2 to extend the scope of the term "promoter" for the purposes of Sec. 81 of the Act to include persons authorizing the issue of securities by way of an "offer for sale" unless such persons have had possession of the securities offered for not less than two years. The full terms of this Bill are set out on page 203. It should be noted that the term "securities" is used in this Bill in the same sense as it is used on the Stock Exchange, and includes shares and stock which, strictly speaking, do not come within the scope of that term.

### **Duties of the Promoter.**

The promoter is looked upon by many as a rogue, and often condemned without trial, for it cannot always

be said that he is a benefactor to the public as there are, unfortunately, many unscrupulous persons acting as promoters of limited companies who offer their goods, in the form of shares, in preference, to clerks in holy orders, old ladies, and retired soldiers. It is wrong, however, to condemn all promoters for the misdeeds of a section of them, for there are many honest men in their ranks, and it would appear that it generally depends upon the dividends paid after the promotion of the company whether the promoter is considered honest or dishonest. This is not a good test, for there is the case of a limited company which was promoted many years ago, and has since repaid the original capital, in dividends, many times over, but no one was more surprised to find the property productive than the promoters whom, doubtless, the shareholders consider honest.

The Companies (Consolidation) Act, 1908, has done much to keep the unscrupulous promoter within due bounds. Especially is this so in the case of the issue of a prospectus, as Sec. 81 of the Act requires very full information to be given in this document with regard to the promoter's interest and activities in the promotion.

The principal work of the promoter in connection with the formation of such a public limited company as that under consideration in this book would be as follows—

(a) Carry through all negotiations with reference to the purchase of the going concerns to be taken over by the newly formed company, and enter into provisional agreements with the vendors.

(b) Obtain reports on the concerns to be taken over from experts.

(c) Settle the company's name, domicile, objects, and capital.



(d) Arrange for appointment of directors, brokers, bankers, and officers of the company.

(e) Arrange for printing of copies of the Memorandum and Articles of Association.

(f) Arrange for registration of the company and obtain certificate of incorporation.

(g) Make all preliminary arrangements for the issue of capital and underwriting it.

### **Relation of Promoter to the Company.**

The promoter's duties are onerous, for from the moment he commences the formation of the company he stands in a fiduciary relation to it as if he were a trustee, and this is so with regard not only to the company as originally constituted, but also to future allottees. He is, therefore, liable to account for secret profits in the same way as a director, and if he wishes to sell his own property to the company he must either obtain the appointment of an independent board of directors, or fully disclose all the facts to the public by means of a prospectus. He cannot be relieved of this liability by a provision to that effect in the regulations of the company.

In the recent case of the liquidator of the *Jubilee Cotton Mills, Ltd.*, v. *Lewis*, 1924, it was emphasized that a promoter must not make any secret profit in connection with the promotion of a company, whether he actually derives such profit directly from the company or through third parties, and this is so even where he has been deceived or defrauded by those third parties.

The promoter is neither a trustee nor an agent of the company because the company is not yet in existence, and it is one of the fundamentals of the law of agency that for a person to be acting as agent, the principal must be in existence at the time the contract was

made, but, as already stated, he stands in a fiduciary relation to it as though he were a trustee.

The death of the promoter does not release his estate either from the obligations he has undertaken to find capital or from liability for moneys claimed by the company in respect of a breach of his fiduciary duties or in respect of secret profits retained by him. But where the estate has not benefited the cause of action will not survive (*Peck v. Gurney*, 1874). Bankruptcy also does not discharge or free him from these liabilities.

### **Preliminary Contracts and Expenses.**

CONTRACTS. The contracts made by the promoter before the company comes into existence are not binding on the company, and, as there is no agency, it cannot ratify them when it does come into existence. There must be an entirely new contract between the company and the promoter in the same terms as the provisional agreement entered into by the promoter with the vendors.

If the company refuses to take over the concerns, the promoter remains personally liable, but he usually protects himself against this unlikely event by stipulating in the purchase agreement that if the company does not, for any reason, take over the business from him within, say, two months of signing the agreement, either party may rescind the contract.

EXPENSES. The promoter is liable for all promotion or preliminary expenses unless the company agrees under seal or for valuable consideration to relieve him of this liability.

The preliminary expenses may usually be written off in the Profit and Loss Account of the company over a period of from three to five years. It is, of course, a wise proceeding to clear this item from the

books as soon as possible, but the argument in favour of spreading the writing off over the period mentioned is, that where this procedure is not carried out the later shareholders will reap the benefit of profits which should have accrued to shareholders in the earlier years of the life of the company. Any premium on shares is generally utilized for writing off these expenses.

The preliminary expenses will consist of—

(1) Stamp duties and fees on the nominal capital, and stamps on contracts transferring the assets.

(2) Law costs of preparing Memorandum and Articles of Association, contracts and prospectus, and of obtaining registration of the company.

(3) Fees for experts' reports.

(4) Printing Memorandum and Articles, prospectus, forms of application, letters of allotment, letters of regret, statutory books, and the first books of account.

(5) Advertising prospectus and expense of issue of same.

(6) Underwriting and overriding commissions and brokerage.

The amount or estimate of preliminary expenses must be stated in the prospectus and also in the statutory report required by Sec. 65 of the Act.

### **The Promoter's Agents.**

It may be accepted as a truism that "a promoter is known by the company he keeps." The promoter who has not much faith in the concerns promoted by him usually retains the services of one or more blood-hounds, known in the City as "City Runners," who, for a consideration which may or may not be considered by them to be adequate, scent out likely subscribers by a systematic process of touting. It is safe to say that, as a rule, such concerns may be left severely alone

by the investor who wishes to see any return on the capital parted with. Many promoters of these concerns usually have one object in view, which is, to provide office rent, directors' fees, and managers' salaries. As the capital of one concern goes to satisfy this object, so the company is reconstructed with a consequent assessment on the shareholders for a similar beneficent purpose.

On the other hand there are now many excellent issuing houses who, for a small commission, undertake to find the necessary capital for sound promotions; but undoubtedly the best arrangement is for the company to make the issue of capital itself, utilizing the services of a responsible firm of stockbrokers who are members of the London or Provincial Stock Exchanges.

### **Promoter's Profit.**

The promoter usually adopts one of the following ways of making his profit on the promotion, viz.—

(1) He may buy the business including goodwill or stock-in-trade, and sell to the new company for the purchase price plus an extra amount for goodwill or stock-in-trade at valuation; or

(2) He may sell the assets to the company at the valuation placed upon them by his own valuers, which is usually in excess of the purchase price at which he has purchased them; or

(3) He may be paid a commission on the purchase consideration; or

(4) The company may vote him a sum of money for his services in the promotion with or without giving him also a block of shares.

(5) In addition to the above he may also stipulate for a seat on the board with high directors' fees.

The promoter may decide to take his profit in one of the following ways—

- (1) Wholly in cash.
- (2) Wholly in shares or debentures.
- (3) Partly in cash and partly in shares or debentures, and the measure of his confidence in the concern will be judged in accordance with the method he adopts.

### **Taxation of Promoter's Profit.**

The promoter's profit is liable to income tax and, in the case of an individual or firm, also super-tax, in the same way as the profits of an ordinary individual, firm, or company.

No difficulty arises where the purchase consideration is received wholly in cash, for the assessable profit will be the amount received less the purchase consideration payable by himself to the original vendors, and any expenses of promotion he may be called upon to pay.

Where, however, the purchase consideration is payable in shares, or partly in shares, he may either—

(1) Adopt an estimated value of the shares in agreement with H.M. Inspector of Taxes, and pay upon that figure less his promotion expenses, etc. ; or

(2) Take three years in which to realize the shares, paying tax on the sums realized less the proportionate part of his promotion expenses, etc., and tax on the balance of the shares remaining at the end of the three years at a valuation placed upon them by the Commissioners of Inland Revenue less the balance of the expenses uncharged.

Where the promoter is an individual and does not make a habit of promoting companies he may very well not be liable to tax on his promotion profit if he can show that it is merely a casual profit, and that he does not carry on a company promoting business.

**Liability of Promoter.**

In addition to the liability to account for secret profits already mentioned, the promoter is liable for negligence or breach of trust in relation to the business and assets of the company, and an action may be brought against him while the company is a going concern if damage has been suffered by the company, or he may be proceeded against under Sec. 215 of the Act after liquidation has commenced.

## CHAPTER III

### EXPERT REPORTS

THE promoter, having opened negotiations for the purchase of suitable "going concerns" which he may utilize in order to turn an honest penny by selling to the limited company he is about to form, obtains the services of a professional accountant to investigate the books and accounts of these concerns, and to make a report, showing the profits, turnover, etc., and valuers to make a valuation of the assets for underwriting and prospectus purposes.

#### **Definition and Status of Expert.**

The expression "expert" is defined by Sec. 84 of the Act as including engineer, valuer, accountant, and any other person whose profession gives authority to a statement made by him.

The promoter should use every care in his choice of experts. He must satisfy himself as to their qualifications if he is to avoid liability under Sec. 84 of the Act, for untrue statements contained in any report or memorandum of such experts or copies thereof.

Sec. 84 of the Act provides that any director, person named, promoter, or other person who authorized the issue will be liable for "any untrue statement in any such report or memorandum purporting to be a statement by or contained in what purports to be a copy of or extract from a report or valuation of an expert, where it is proved that the director, person named, promoter, or other person who authorized the issue of the prospectus or notice, had no reasonable ground to believe that the person making the statement, report, or valuation was competent to make it."

The status of the expert would be judged by his professional standing, and the definition given in Sec. 84 seems to imply that he must possess some recognized professional qualification. What is, or is not, sufficient qualification would have to be decided on its merits in an action brought under the section.

The full liability of persons responsible under Sec. 84 is dealt with on page 218, but the importance of care in the choice of experts has been specially emphasized here.

### ACCOUNTANT'S REPORT

**ESTIMATES OF PROFIT.** Attempts are sometimes made by promoters to persuade accountants to make estimates of future profits in their report. This should on no account be done. Any statements as to, or estimates of, future profits should be left for the directors themselves to make outside the accountant's report. The accountant must not make any statement unless it is founded on fact, the responsibility for statements of belief, hope, or opinion being left to those authorizing the issue of the prospectus.

**OBJECT OF REPORT.** The accountant's business is to report on past facts with a view to giving the investing public some indication of the future earning capacity of the business in order that they may form their own opinion as to the merits of the case.

It must be remembered that the accountant not only owes a duty to his client with regard to the purchase, but he has an equally important duty with reference to the investing public, for subscriptions to the issue will very largely be influenced by his report. Too much care and skill cannot, therefore, be expended on the preparation of this report in order that the public may in no way be misled by it.



**METHOD OF PREPARING REPORT.** The method of preparing the report will depend upon the amount of information the promoter wishes to give the public, and the scope of his instructions. The report may include the following information—

- (1) Profits of past years.
- (2) Turnover.
- (3) Past rates of dividends paid.
- (4) Amounts written off by way of depreciation.
- (5) Amounts put to reserve.
- (6) Amounts carried forward.
- (7) Capital employed in the business.
- (8) Issued share capital.

Percentages and averages should, in the writer's opinion, always be avoided in connection with profits, as they usually convey little to the mind of the investor, and are much more likely to be misleading than helpful.

The period to be covered by the report will usually be fixed by the promoter on the advice of his accountant, but it will be obvious that the confidence of the public will be increased or diminished according to the length of the period chosen.

Where accounts, audited by a member of one of the recognized bodies of accountants, are available, the work of the investigating accountant will be much simplified as, in such a case, he is entitled to rely, to a certain extent, upon the certificate of his confrère, and it will not therefore be necessary, as a rule, for him to make an exhaustive inspection of the books.

Balance Sheets and Trading and Profit and Loss Accounts covering periods from five to ten years should be prepared or obtained. These balance sheets and accounts should then be arranged in tabular form to facilitate comparison. Any violent fluctuations revealed by such comparison in items of expense, turnover, percentage of gross profit on turnover,

stocks, etc., should be carefully enquired into and special enquiry should be made as to whether any capital expenditure has been charged in the Trading and Profit and Loss Accounts or whether any expenditure of a strictly Revenue nature has been capitalized.

The comparison of items of expense, such as rent, traveller's commission, rates and taxes, where the same are on the decline, will often reveal, on enquiry, the undisclosed fact that branches, • departments or agencies, from which large profits have been derived in the past, and which have been included in the accounts submitted, have latterly been abandoned owing to losses made by them in recent years.

In comparing turnover, quantities should, where possible, be compared as well as values in order to ascertain whether any fluctuations in the annual turnover are due to increase or decrease in the volume of business done, or merely to fluctuations in the market price of the goods sold.

In these days, when the prime cost of goods sold and selling prices bear little or no constant ratio to each other, there is not a great deal of information to be obtained from a comparison of the percentage of gross profit on turnover, except in the cases where extreme fluctuations in cost of raw material, labour, and selling prices do not obtain, when such a comparison may reveal manipulations of stock valuations.

It must be remembered that it is only natural for the vendor to desire to make the most of his business for selling purposes, and while he may have religiously adhered to the formula for valuation of stock in trade for ordinary accounting and taxation purposes, "cost or market price whichever is the lower," he very often attempts to value his final stock for selling purposes on the basis of "cost or market price whichever is the higher." A comparison of the stock valuations and

a strict investigation of the final stock sheets should lead to the disclosure of any such tendency, and thus prevent the consequent inflation of profits.

Prices of manufactured goods should be checked with the cost records, if any, and compared with present market prices. Prices of merchanted goods—these are goods bought complete for re-sale—should be checked by inspection of invoices, the invoice price being then compared with present market price.

The tabulation and comparison of the balance sheets will reveal fluctuations in—

- (1) The amount of depreciation written off the various assets.
- (2) The nature of the capital of the concern.
- (3) The liquid assets.
- (4) Working capital.
- (5) Loanable capital.

It is important to know whether the concern has been hampered by lack of working capital, that is, the excess of liquid assets over current liabilities, or credit. Where such a state of affairs exists it will usually be revealed by a comparison of the liquid position and loanable capital in each year.

If the accountant is a student of psychology he will glean a good deal of information from a study of the management, clerks and servants of the business he is investigating, which will indicate how far he can accept the matter placed before him as fact. Time spent in this direction has been saved over and over again, and facts have been disclosed which might have laid dormant if the accountant had not entered into the mind of the individual he was dealing with. It is not suggested, however, that the accountant should be a thought reader, but he should be a man of discernment.

### Profits for Prospectus Purposes.

The profits stated in the accountant's report, as published in the prospectus, will not, as a rule, be exactly the same as the profits shown by the audited accounts submitted to him during his investigation, by reason of the fact that certain adjustments will have to be made according to the circumstances revealed during his investigation.

The adjustments to be made will depend entirely upon the circumstances of each particular case, but those usually necessary are as follows—

(a) Items charged in the accounts which may be written back for prospectus purposes—

(1) Partners' salaries provided directors' fees are substituted.

(2) Interest on partners' capital.

(3) Interest on loans, debentures, or bank overdrafts where such loans, etc., will not be continued by the purchasing company.

(4) Dividends.

(5) Excess Profits Duty, Mineral Rights Duty, and Corporation Profits Tax, as these no longer obtain. Some accountants argue, however, that Excess Profits Duty represents the abnormal profit made during the War, and should be allowed to remain as a charge in the accounts in consequence.

(6) Income tax, because this item is in the nature of an appropriation of profit, and is, in any case, taken into consideration by the investing public when calculating the net yield likely to be obtained from such an investment.

(7) Losses made by branches, departments, or agencies which are not to be taken over by the purchasing company.

(8) Capital expenditure charged to revenue.

(9) Depreciation should always be charged against

the profits, except in those isolated cases where the true depreciation cannot be ascertained, that is, where the assets have been over-depreciated in past years either for the purpose of creating secret reserves or for increasing the financial resources of the concern.

(b) Items credited in the accounts which should be excluded from the profits—

(1) Interest on investments not taken over by the purchasing company.

(2) Profits made by branches, departments, or agencies not taken over.

(3) Refunds of Excess Profits Duty and repayments of Corporation Profits Tax and Income Tax.

(4) Capital profits credited to revenue.

The accountant must, however, be careful to show in his report that the stated profits are arrived at before charging the excluded expense items.

The object of these adjustments is to present to the investor the facts of the past in such a form as will readily enable him to apply them to present conditions.

### **Turnover.**

In arriving at the turnover for prospectus purposes care must be exercised in seeing that all returns, allowances, and trade discounts are deducted, and also, in the writer's opinion, bad debts should be deducted from the turnover of the year in which the debt was incurred.

It must also be seen that the turnover only includes sales of trading commodities, and does not include the sale of articles of a capital nature, such as plant and machinery.

If possible, and where they are of any magnitude, "House Transactions" should be traced and excluded where they form part of the turnover, but which afford

the concern no profit. It is often the case that employees are permitted to buy, through the firm, from wholesale houses, such transactions being included in the record of the firm's purchases and sales. Also, employees are allowed in many cases to purchase goods from the firm at cost price. The inclusion of such items in the sales, although not affecting the profit because they are likewise included in the purchases, would inflate the turnover and consequently mislead the investor, where the items are heavy, as to the volume of business done by the concern.

### VALUERS' REPORTS

The assets will be valued, on the instructions of the promoter, by engineers, chemists, surveyors, etc., and a report will usually be made by these experts not only as to the value of the plant and machinery, but also as to its estimated earning capacity.

The valuers' reports are no less important from the investor's point of view than that of the accountant, and will probably be more so in the case of an issue of debentures giving a charge on the assets. It is necessary, therefore, that firms of repute be employed, and valuers who may be termed "armchair valuers" should be avoided, for it is essential that the valuer inspect the assets himself, and does not rely merely upon information supplied to him by the vendors or promoter, as both these parties have usually interests in common in relation to the company, but which are directly opposed to those of the company, for the vendor desires to make the best of the sale and the promoter desires to have a sufficient margin for his profit.

An over-valuation, which means an excessive writing up of the value of the assets in the books of the purchasing company, would undoubtedly lead to subsequent trouble, possibly involving the difficulties and

dissatisfaction of shareholders entailed by a reduction of capital.

The assets will not, of course, be valued at break-up price, but must be valued in the light of their utility to the company as a going concern, special attention being directed to their earning capacity.

Much time and trouble will be saved if the valuers make a separate valuation of each class of asset instead of, as is often the case, giving a valuation of the assets as a whole, leaving the directors to apportion such valuation subsequently. This is important also from the point of view of taxation, as the new values placed upon the assets by competent valuers will be received by the Inland Revenue without question for purposes of wear and tear allowance, but where the values are apportioned by the directors, the result is, usually, a long drawn out argument with H.M. Inspector of Taxes as to the proper value of the assets. Directors do not always take notice of taxation in this respect, for their paramount anxiety is to please shareholders by payment of dividends and consequently this is bound to be reflected in any apportionment made by them and leads to non-depreciating assets such as freehold land being valued at a maximum figure, thus relieving the Profit and Loss Account from a heavy charge for depreciation of such assets as plant and machinery which, in consequence, have not had their proper proportion of the purchase consideration allocated to them. Where the dividends are secure, however, the apportionment will be worked in the reverse way in an attempt to get a greater allowance from taxation in respect of wear and tear.

### **Experts' Reports and Promoter.**

The experts must keep in mind that their reports will not only be required for prospectus purposes, but

will be the deciding factor in the purchase or otherwise of the business, for upon receipt of the Accountant's Report showing profits and turnover, and the Valuers' Reports showing the valuation of the assets, the promoter will decide whether or not he has a chance of obtaining slight compensation for his labour by promoting the company. If he then decides to go on with the promotion he will instruct his solicitor to prepare the agreement as between himself and the vendors. Such agreement may or may not provide for the discharge by the vendors of the existing liabilities of the concerns to be purchased. The solicitor will arrange for the agreement to be signed when ready, and the deposit will be paid at the same time. The amount required as deposit varies, according to the nature of the concern to be purchased, from 1¼ to as much as 10 per cent on the total purchase consideration, and forms the principal stake of the promoter in the venture, for the agreement usually stipulates for the forfeiture of the deposit if the contract of purchase is broken for any reason not attributable to the conduct of the vendors.

In coming to his decision as to the continuation of the venture the promoter will have to consider the capitalization of the company on the basis of the experts' reports, and where there is any doubt of its eventual success he may endeavour to gain time, in order to see which way the wind is going to blow, by purchasing an option on the business for a limited period, say, three to six months, instead of immediately closing with the purchase. The promoter may thus limit his loss to the extent of the option money, which is usually very much less than the deposit he would have to pay on signing the agreement of purchase.



## CHAPTER IV

### CAPITALIZATION OF THE COMPANY

THE promoter, having decided upon the promotion profit he intends to take and the form thereof, fixes the capitalization of the company and submits the terms of the prospectus to his solicitor. The promoter will fix the form of capitalization after taking into consideration the advice of his solicitor, accountant, and broker.

#### **Scope of Capitalization.**

In arriving at the proper figure at which the concern is to be capitalized, special consideration will have to be given to the working capital required to carry on the business, in relation to which particular care must be exercised to provide for any extension of the activities of the business to which the directors may have pledged themselves in the prospectus such as—

- (1) Opening new branches, departments, or agencies.
- (2) Advertising specialities.
- (3) Laying down new plant and machinery, etc.

The capital of the company will then be fixed to cover the following—

- (1) Purchase consideration as between promoter and the original vendors ;
- (2) Promotion profit and expenses of promotion where these latter are payable by the company ;
- (3) Preliminary expenses payable by the company and not included in the expenses of promotion ; and
- (4) Working capital necessary to carry on the business.

It is most important that care be taken to see that

such capitalization covers all the immediate requirements of the company as, when the Memorandum and Articles have been registered, this capital becomes the authorized capital of the company, beyond which it cannot issue except, as shown later, by going to more trouble and expense.

## SHARE CAPITAL

### Form of Capital.

The amount of the capital with which a company limited by shares proposes to be registered, divided into shares of fixed amount, must be stated in clause five of the Memorandum of Association.

A share has been defined as: "The interest of a shareholder in the company measured by a sum of money, for the purpose of liability in the first place, and of interest in the second, but also consisting of a series of mutual covenants entered into by all shareholders *inter se*."

The utmost freedom is given by the Act in fixing the nominal value of each share. The share capital may be divided therefore into shares of any denomination, that is to say, they may be shares of 1d., 1s., £1, £100, £10,000 each, or any other amount; in fact there are cases of private companies having been registered with £1 nominal capital divided into shares of one farthing each, and recently there was the registration of a private limited company, formed for the purpose of carrying on the business of auctioneers, house agents, architects, and surveyors, with a nominal capital of one halfpenny divided into two shares of one farthing each, the duty and fees upon which amounted to £5. In cases such as these, however, the credit of the business would undoubtedly be affected by the registration, as such a small nominal capital lends itself to

the suggestion that registration has been effected merely to avoid liability or that the balance of the net assets of the business is represented by debentures issued to the vendors.

The nominal capital may be divided into shares of different classes carrying rights separate and distinct from each other. Such rights either may be defined in clause five of the Memorandum or they may be left to be fixed by the Articles.

In fixing the nominal value of the shares it should be remembered that a high value restricts their marketability. Where the nominal value exceeds £1 per share it will usually be found that the market in the shares tends to become restricted, so much so that companies which originally fixed the value of their shares over this amount have subsequently had to reorganize their share capital in consequence by issuing, say, five £1 shares in exchange for each share of the nominal value of £5, and this in spite of the fact that the capital and dividend thereon were well secured.

### **Classes of Share Capital.**

The share capital may be divided into various classes of shares of which the following are the principal—

(1) PREFERENCE SHARES. Preference shares may give either a preference as to payment of dividend or priority as to return of capital in the event of winding-up the company, or both, over other classes of shares.

(a) *Preference as to Dividend.* The preference as to dividend may attach to arrears of dividend as well as to the dividend of the current period or may be restricted to the latter, that is to say, the dividend may be either cumulative or non-cumulative.

(i) Cumulative preference dividend. In the absence of a stipulation to the contrary in the clause of the Memorandum or Articles defining the preferential

rights of such shares, all shares which are stated to be entitled to a preferential dividend at a fixed rate per cent are *primâ facie* deemed to be cumulative as to dividend. There is, therefore, really no need to describe such shares as Cumulative Preference Shares, or to describe the dividend as a Cumulative Preference Dividend, but in order to prevent mistakes on the part of the layman and as a matter of emphasis this is invariably done.

A cumulative preference share carries the right to be paid, out of future profits, all arrears of dividend on such shares before any dividend whatsoever is paid on subordinate classes of shares.

With regard to the treatment of arrears of cumulative preference dividends in the accounts, the majority of accountants are of opinion that as the liability does not accrue until there are sufficient profits available to pay the dividend, such arrears should not be dealt with as an actual liability, but should be recorded in the form of a note on the liabilities side of the balance sheet in the nature of a contingent liability. The note should take some such form as: Note.—There are arrears of Dividend on the Cumulative Preference Shares for the periods —— amounting to £——.

Without this note it cannot be said that the balance sheet shows the true and correct view of the state of the affairs of the company, and such an omission would probably mislead persons into buying shares which they would not or might not have bought had they known of such arrears.

It should be carefully noted by the investor whether the cumulative preference attaches to such shares permanently, that is to say, so long as the shares exist, or not; for sometimes shares are given cumulative preferential rights for a specified period or until a certain condition is fulfilled, after which they become

non-cumulative or may lose all right to preference, e.g. it may be provided that the dividends on such shares shall cease to be preferential on the payment of a specified rate of dividend on some subordinate class of shares for a term of years, or the preference shares may be convertible into ordinary shares over a specified period.

(ii) Non-cumulative Preference Dividend. Where it is intended that the dividend on the preference shares is to be non-cumulative, great care must be exercised in seeing that this intention is clearly expressed in the clause of the Memorandum or Articles defining the rights attaching to such shares, otherwise, as already stated, the dividend may be deemed to be cumulative, in which case the company may find itself in difficulties, as the rights of the holders of subordinate classes of shares might be materially affected.

A provision that a dividend of so much per cent shall be payable on such shares out of the Net Profit of each year would be effective.

Non-cumulative preference shares are entitled to payment of dividend only in so far as the profits of the year allow of such a payment. If the profits are insufficient to pay this dividend there is no right to have arrears paid out of profits of future periods as in the case of cumulative preference shares.

(iii) General Consideration of Preference Dividends. The dividend payable upon both classes of preference shares will be at a fixed rate per cent, with or without a right to share in surplus profits after payment of stipulated dividends on subordinate classes of shares. The articles of the company will decide whether the fixed rate of dividend is to be calculated on the nominal value of the shares or on the amount paid up thereon. In the case of companies working under Table "A" the calculation must be made on the paid-up capital

unless nothing has been paid up, when it may be calculated on the nominal value. (Clause 98 of Table "A.")

The Articles will also state whether arrears of cumulative preference dividend have any priority in a winding-up, and usually provide that in a winding-up preference shareholders shall have priority as to arrears of dividend whether declared or not up to the commencement of the winding-up.

In the case of *Crichton's Oil Co., Ltd.*, 1902, it was decided that *primâ facie* a preference dividend is payable out of the profits made by the company while it is a going concern, and it requires a special provision to give holders a right to have arrears paid out of the assets in a winding-up.

(b) *Priority as to Return of Capital.* A preference shareholder is not entitled to a return of capital in a winding-up in priority to other shareholders unless the Memorandum or Articles of the company so provides. If no such provision is made the preference shareholders will rank *pari passu* with the ordinary shareholders in any distribution of the assets, that is to say, they will both receive back their paid-up capital or, on insufficiency of assets, will abate proportionately, any surplus assets being divided between them in proportion to the amounts paid up on their respective holdings.

Apparently where preferential rights, as to either capital or dividend, are attached to preference shares, there will be no right to any further share in the assets, after repayment of capital, unless provision is made in the Memorandum or Articles for the same. (*National Telephone Co.*, 1913.)

The rights of preference shareholders as to return of capital, sharing in surplus assets, etc., in the event of liquidation cannot be too clearly defined, as many cases have been decided within the last few years,

the decisions in which are apparently in conflict with each other, and in consequence still leave a certain doubt on the whole subject. A carefully and definitely worded clause in the Memorandum or Articles dealing with the rights of such shareholders is the best method of removing all doubt.

(c) *Participating Preference Shares.* Preference shares may also be given participating rights in which case they will be styled participating preference shares, or, if they also have the rights aforementioned, cumulative participating preference shares.

The holders of such shares are given the right to receive their fixed dividend in priority to holders of subordinate shares after payment of which a specified rate of dividend will be paid on the subordinate shares when a further right will be attached to the participating preference shares to share in any remaining surplus with the ordinary or deferred shareholders in the proportions fixed by the regulations of the company, e.g. they may be 7 per cent cumulative participating (up to, say, 10 per cent) preference shares, which means that the holders of such shares will receive 7 per cent in priority to the ordinary shareholders and, after payment of a specified rate of dividend on the ordinary shares, will be entitled to share equally with the ordinary shareholders in the surplus up to a further 3 per cent, any balance still remaining going to the ordinary shareholders.

(d) *Convertible Preference Shares.* In addition to the foregoing, preference shares may also be given the right of conversion into ordinary shares up to a specified date. If they then have all the rights mentioned in this chapter they would be styled cumulative participating convertible preference shares.

This further right is self explanatory, and allows the shareholder to give notice to the company, up to the

date specified, that he requires his holding of preference shares, or a part thereof, to be converted into ordinary shares. On conversion of the shares the shareholder's name will be transferred from the Preference Share Register of members to the Ordinary Share Register, and he will then cease to have the benefit of the priorities attaching to the preference shares. A note should be made in the Preference Register of the fact of conversion of the holding together with the date thereof. The Preference Share Certificate will be exchanged in due course for an Ordinary Share Certificate, and care should be exercised to see that the Preference Certificate is cancelled.

The notice of conversion is usually required to be in writing, in which case the letter giving notice should bear the folio of both registers of members after the necessary records have been made in those books.

The conversions will necessitate transfers being made in the books of account from Preference Share Capital Account to the Ordinary Share Capital Account.

It will readily be seen that this right of conversion may be very valuable, especially in the case of a new company where little or no information is available with regard to past profits, etc., in which case the shareholder can sit tight with his priorities until he sees how the company is shaping, when he can decide whether it is likely to be more profitable to hold ordinary shares or not, and exercise his right of conversion accordingly.

(e) *Right of Preference Shareholders to Reports, etc.* Preference shareholders in public limited companies have by Sec. 114 of the Act equal rights with the ordinary shareholders to receive and inspect the balance sheets, reports of the directors, and auditors' reports. This right also extends to debenture holders in a public company, but does not extend to preference share or debenture holders in private companies.



(f) *Voting Power of Preference Shareholders.* The voting power of preference shareholders will be fixed by the articles, and is usually equal to that of the ordinary shareholders, but sometimes, although the stock exchange looks with disfavour on the practice, preference shareholders are given no voting rights whatsoever except those they possess under the Act itself in connection with reconstructions and alterations in the rights of the shareholders. The more common practice is to restrict the voting power of preference shareholders to matters in which they are directly affected or only to allow them to vote if their dividends are in arrear.

The following is a typical clause dealing with votes of such shareholders—

The preference shares shall not confer on the holder the right to attend or vote at any general meeting, unless at the time of convening the meeting the dividend on the class shall be three months in arrear. Provided that if the business of the meeting includes the consideration of any resolution directly affecting the class and not similarly affecting all other classes, or any resolution for amalgamation or winding-up, the preference shares shall confer the right to attend and vote upon the resolution.

The object of such a provision is to prevent preference shareholders obtaining control of the business by electing directors under their control, and thereby restricting the development of the business. The preference shareholders are concerned only in preserving the business on a basis safe enough to provide their preference dividend, while the object of the ordinary shareholders would be to extend the business continuously, and they would take a certain commercial risk to do so in order not only to reap profit from which to pay the preference dividends but to increase the profit available for distribution to themselves.

It is therefore important that where equal voting

rights are given to the two classes of shares, the promoter, in fixing the share capital of the company, should see that the different classes of shares are so well balanced that the control of the company does not pass into the hands of the holders of a preferential class of share to the prejudice of the ordinary or deferred shareholders; for these latter shareholders must of necessity satisfy all prior interests before they can reap any benefit from their own holdings.

(2) ORDINARY SHARES. Ordinary shares are those to which attach the right to take all surplus profits after satisfaction of prior interests subject to the rights attaching to any deferred shares.

Where there are both cumulative and non-cumulative preference shares, the latter are very often given a fixed dividend and described as Second Preference Shares, Ordinary "A" Shares, or Ordinary "B" Shares, as the case may be. Where there are two classes of ordinary shares there will generally be some such distinction as follows between the "A" and "B" shares—

(a) In the rights of the holders as to—

- (i) Payment of dividend; or
- (ii) Repayment of capital on winding-up; or
- (iii) Voting power.

(b) As to the nominal value of the shares, e.g. the "A" shares may be of 2s. nominal value and the "B" shares £1, all other rights being equal.

Where there are deferred or founders' shares the ordinary shareholders will receive a fixed rate of dividend in priority to the deferred shareholders and may, or may not, then participate with them in any surplus.

(3) DEFERRED OR FOUNDERS' SHARES. Deferred or founders' shares give the holders a right to the whole or a share of the surplus profits of each year which

may be available after paying any preference dividends and a fixed dividend on the ordinary shares, and also a right to share in any surplus assets in a winding-up.

Deferred shares are usually issued as fully paid to vendors or promoters as part of the purchase consideration, and are in most instances of small nominal value. They are, as a rule, however, entitled to a very large share of the surplus profits, and sometimes to the whole of such profits, or they may be given the right to participate equally with the ordinary shareholders therein.

It is important to see that the implied power of directors to put to reserve any sum they consider necessary before the payment of dividends is expressed in the Articles, as the holders of deferred shares are usually very keen on dividing the profits up to the hilt, thus jeopardizing the stability of the business.

The number of founders', management, or deferred shares, if any, and the nature and extent of the holder's interest in the property and profits of the company must be stated in any prospectus issued by the company to comply with the provisions of Sec. 81 of the Act.

In order to make the position of the holders of founders' shares secure, the rights attaching to such shares are usually set out in the Memorandum, as they are not then so easily altered as would be the case if they were merely defined in the Articles.

(4) CO-PARTNERSHIP SHARES. Co-partnership shares are those issued to employees under some scheme of co-partnership, and may or may not carry voting powers, but are frequently given preferential rights as to both dividend and repayment of capital in the event of winding-up, or they may be given a right to dividend at a fixed rate after payment of a certain dividend on the ordinary shares.

As a rule, however, the holders of such shares are

precluded from attending meetings, voting, and having any voice in the management of the concern in which they are shareholders.

The Articles will decide under what conditions co-partnership shares may be issued, and will usually provide that the consent of the company in general meeting must be obtained by a specified majority before such shares can be issued.

Co-partnership shares are not usually transferable, although they may be so, and a condition of issue is usually made that in the event of the employee leaving the service of the company the shares are to be transferred to a nominee of one of the directors or to the secretary, at a fixed price or a price to be agreed upon, or at the market price, if any. Stipulations are also very often made as to the surrender of the shares in the case of the misconduct of the employee. On the other hand, these shares are sometimes issued with rights equal in all respects to those of other classes possessed by shareholders who are not employees.

This class of share would not concern either the promoter or the company at this early stage in the company's history, and as such shares are never issued to the public they are merely mentioned here as one form of share capital.

(5) STOCK. *Power to convert Shares into Stock.* Under Sec. 41 of the Act a company, if so authorized by its Articles, may convert all or any of its paid-up shares into stock or re-convert that stock into paid-up shares of any denomination. This power is, however, very rarely taken advantage of by industrial companies.

*Mode of Conversion.* The mode of converting shares into stock will be governed by the Articles, which may require a special ordinary or extraordinary resolution of the company in general meeting for the purpose; or the power to convert may be vested in the directors.

If the Articles do not contain power to convert shares into stock or to re-convert stock into shares, this can nevertheless be done by one special resolution.

*Notice of Conversion to Registrar.* Notice must be given to the Registrar of Joint Stock Companies under Sec. 42 of the Act as to the conversion of shares into stock or a re-conversion of stock into shares, specifying the shares or stock converted, and every copy of the Memorandum issued after the date of such conversion or re-conversion must be in accordance with the alteration.

*Differences between Stock and Shares.* The chief differences between stock and shares are as follows—

(a) Stock must be fully paid up. Shares may be partly paid up.

(b) Subject to the regulations of the company, stock may be issued or transferred in fractional parts. Shares cannot be issued or transferred below the nominal amount of each share.

(c) Stock has no distinctive numbers. Each share is distinguished by a separate number.

*Effect of Conversion on Register of Members.* Sec. 43 provides that where a company having a share capital has converted its shares into stock, and given notice of the conversion to the Registrar of Companies, all the provisions of the Act which are applicable to shares only shall cease to apply as to so much of the share capital as is converted into stock; and the register of members of the company, and the list of members to be forwarded to the Registrar, shall show the amount of stock held by each member instead of the amount of shares and the particulars relating to shares herein-before required by this Act.

In the financial books the nominal value of the shares will be transferred from the Share Capital Account to the Stock Account.

*Transfer of Stock.* Stock is transferred in the same manner as shares. The regulations of the company will provide for the mode of transfer, that is to say, whether in common form or by deed.

### **Fixing Dividend on Preference Shares, and Interest on Loanable Capital.**

In fixing the rate of dividend on preference shares or interest on loanable capital, the following factors must be considered—

- (1) The basis for gilt-edged securities; and
- (2) The degree of risk run by the concern in trading; and
- (3) The security afforded by the investment; and
- (4) The demand for such an investment in the market.

That is to say, the basis for gilt-edged securities, such as British Government Stocks, which at the present yield a return of about  $4\frac{1}{2}$  per cent, will be taken as the foundation; to this must be added a percentage for commercial risk, varying according to the standing of company, the security afforded by the investment, and the demands of the investor, usually from 2 to 5 per cent. Where the concern is engaged in a highly speculative business, such as a mining company, a much higher percentage would have to be added or, to be attractive, ample participating rights would have to be given in addition to the fixed rate of dividend. It is unusual, however, for such speculative concerns to issue any other class of shares than ordinary shares.

The dividend or profits record of the concerns to be purchased must also be taken into account and allowed for when fixing the percentage to be added for commercial risk.

The valuation of the shares for issue purposes is dealt with on page 215.

The difference between interest on loanable capital and dividends on shares must also be taken into consideration, both when fixing the nature of the capital and when fixing the rate of interest or dividend payable.

Interest on loanable capital is a charge against the profits of the business, and is payable whether profits are earned or not, though the conditions of the issue of such loanable capital may provide that the interest shall be payable only out of profits. Such a condition would, however, be unpopular.

Dividends, on the other hand, as will be seen later, are appropriations of profit, and are payable only out of profits. So that if there are no profits available, a dividend cannot be paid. This also has a material bearing on the accounts of the company, for any liability in respect of outstanding interest must be reserved for, but dividends are only brought to account when declared, subject, of course, to the note already mentioned in the case of arrears of dividend on cumulative preference shares.

### **Factors to be Considered in Deciding Form of Capital.**

The promoter must now decide what form the share capital of the company will take, having regard to the forthcoming issue of capital, and in arriving at his decision he must have regard to the predilections of the investor and the state of the money market, as well as to the requirements of the business which have already been dealt with. He may also have to decide to issue some form of loanable capital in conjunction with the issue of shares in order to meet the needs of the investor.

The following methods are merely put forward as a guide, and are not intended to be exhaustive. The term "investor" is used in a general sense.

(1) TO SATISFY SPECULATIVE INVESTORS. Where there is a speculative spirit prevailing in the market the promoter will decide upon some form of capital which, while presenting risks, offers a high reward in either dividends or capital profit if the business is successful. He will therefore probably decide upon—

- (a) Non-cumulative preference shares with or without participating rights; or
- (b) Ordinary shares; or
- (c) Deferred shares; or
- (d) Ordinary shares with an option to take also a stated number of deferred shares.

(2) TO SATISFY THE SEMI-SPECULATIVE INVESTORS. Where the speculative spirit is not so strong, and the investor is looking more for a fairly safe return on the money parted with rather than for profit to be derived from capital appreciation, it will be necessary to issue shares with priorities over subordinate shares, which at the same time afford scope for a little speculation. The promoter would, therefore, consider the issue of

- (a) Cumulative preference shares; or
- (b) Cumulative participating preference shares; or
- (c) Cumulative convertible preference shares with or without participating rights.

(3) TO SATISFY THE CAUTIOUS INVESTORS. Where the market indicates that the investor is in a cautious mood it will be necessary to offer him greater security not only as to the return upon his money, but as to the capital itself. In order to raise the required share capital it may therefore become necessary to issue some form of loanable capital in conjunction with shares as follows—

- (a) Issue of ordinary shares of low denomination, together with some form of loanable capital giving a charge on the assets, e.g. floating or fixed mortgage debentures.



(b) Loanable capital may be issued giving a right to convert into share capital over a given period, e.g. convertible debentures.

(c) Debentures may be issued together with ordinary shares with a proviso that the debentures will be allotted, on a defined basis, only to those persons also applying for ordinary shares.

No definite form of issue can be laid down, and the promoter must be guided entirely by the circumstances and conditions obtaining at the time of issue.

### CLASSIFICATION OF CAPITAL

The capital of a limited company, as distinct from the shares, etc., comprising it, may be classified as follows—

(1) **AUTHORIZED CAPITAL.** The authorized capital is the maximum amount the company is authorized by its Memorandum to issue, and is the amount upon which capital duty is payable.

This capital is the first item shown on the liabilities side of a company's balance sheet. The amount will be shown in short as a note, as it does not appear in or affect the financial books until it is issued, when that part which has been issued will also appear under the head of Issued Capital.

(2) **SUBSCRIBED OR ISSUED CAPITAL.** The amount of the authorized capital subscribed for or issued is termed the subscribed or issued capital, but must be distinguished from paid-up capital.

(3) **PAID-UP CAPITAL.** Paid-up capital is the amount actually paid up on the issued capital, and will be the amount of the issued capital called up less any calls in arrear.

(4) **CALLED-UP CAPITAL.** Called-up capital is the amount actually called up on the issued capital. Any difference between the called-up and paid-up capital

will represent the calls in arrear, which are debts due from shareholders in respect of their holdings.

Any difference between the called-up capital and the subscribed or issued capital will be the amount of the uncalled capital which represents the contingent liability of the shareholders on the shares, but which does not become an actual liability until the amount is called up. The amount of this uncalled capital will be shown on the liabilities side of the shareholders' balance sheets, where such shareholders keep personal or business accounts, in the form of a foot note as a contingent liability.

(5) RESERVE CAPITAL. A company may by special resolution, in accordance with the provisions of Sec. 59 of the Act, decree that any part of its uncalled capital shall not be capable of being called up except in the event of and for the purpose of the company going into liquidation. The uncalled capital so earmarked is termed Reserve Capital or Reserve Liability, and cannot be dealt with or charged as security for loans by the directors, neither can it be made available again as ordinary capital without leave of the court, but it can, apparently, be wiped out by reduction of capital. A clause, however, to the above effect contained in the Articles as originally framed can be varied by special resolution, allowing the amount uncalled to be called up at any time, but where the special resolution has been passed by the company under Sec. 59 it is irrevocable, and places it out of the power of the directors to call up this amount, even if every shareholder agrees, except in the case of winding-up.

The usual form of resolution for creating such reserve liability is as follows—

That capital of the company to the extent of 10s. per share in respect of the issued £1 ordinary shares shall not be

capable of being called up except in the event of and for the purpose of the company being wound up.

(6) **WORKING CAPITAL.** The excess of liquid assets (which are: cash, bills receivable, investments readily realizable, debtors, and stock in trade), over current liabilities, excluding permanent or semi-permanent loans, is termed Working Capital, and represents the cash, or its equivalent, available for the carrying on or extension of the company's business.

(7) **LOANABLE CAPITAL.** The term Loanable Capital comprises the issue of debentures, notes, and bank loans of a semi-permanent nature. These loans do not form part of the share capital of the company, and must not be confused therewith.

The holding of loanable capital in the company does not make the holder a member, nor does it give him any right to vote at general meetings of the company, nor to take any part in the conduct of the business of the company, so long as the terms of the issue are observed.

The Articles may give a limited right to debenture or note holders to attend and vote at general meetings of the company, but they would not be allowed to vote even in that case at meetings convened for the purpose of passing special or extraordinary resolutions, in which cases only members can vote.

This form of capital is dealt with in the next chapter.

## CHAPTER V

### LOANABLE CAPITAL

THE subject of loanable capital cannot be fully dealt with in a book of this kind, as it would require a book to itself; consequently the subject has been dealt with more particularly from the point of view of debentures.

The term "loanable capital," which is not a legal term, but one of business convenience, should be used only in connection with loans of a permanent or semi-permanent nature or loans made under agreements which require repayment to be made over fairly lengthy periods. Short loans, or loans which require to be paid off within short periods, such as bank overdrafts, are more correctly included in the term "cash creditors." It has already been pointed out that the term "loanable capital" would include debentures, whether secured or not, notes, bank loans of a semi-permanent nature, and the like.

In order to avoid confusion in the public mind the unqualified term "Capital" should never be used in connection with loans of the nature mentioned, but should always be qualified by the word "loanable." For, strictly speaking, such loans do not form part of the capital of the company at all, but are merely a classification of the creditors. The sections of the Act, therefore, dealing with increase, reduction, or reorganization of capital do not affect or apply to loanable capital. This fact is emphasized because students appear to find difficulty in appreciating the distinction, but it must be remembered that "capital" under the Act means share capital or stock, and not "loanable capital."

Before a company can issue any form of loanable

capital it must have power, either express or implied, to borrow.

### **Power to Borrow and Pledge Property.**

TRADING COMPANIES. It would be an extremely difficult matter for a company engaged in trade to carry out the injunction "neither a borrower nor lender be," for at times borrowing is a necessity to the continuance of the company's business. This necessity usually arises from a temporary shortage of working capital or from a temporary embarrassment caused by "long-windedness" on the part of debtors, probably due to trade depression. Where, however, the embarrassment is due to over-trading, that is, trading beyond the capacity of the share capital, a new issue of such capital, and not loans, should be resorted to.

However that may be, the law recognizes that a trading company must have power to borrow as necessity arises, and consequently it gives to every such company an implied power to do so. That is to say, every trading company has a power to borrow whether it expressly takes such power in its Memorandum or not, and co-existent with this implied power is the implied power to pledge its property as security for such loans. The implied power of a trading company to borrow may, however, be limited by the Memorandum or Articles, in which case the company will accordingly be restricted in its borrowings, as any breach of such limitation would be *ultra vires* the company, e.g. the implied power to borrow carries a power to issue debentures as security therefor, but a clause in the Memorandum or Articles to the effect that the company shall not issue any debentures while certain preference shares are in existence would prevent the company making such an issue. .

NON-TRADING COMPANIES. In the case of non-trading companies the law does not give an implied power to borrow and, consequently, there is also no implied power to pledge its property.

A non-trading company must therefore have express power in its Memorandum before it can borrow, but where there is such an express power to borrow there would also be an implied power to pledge its property as security.

BORROWING BEYOND EXPRESS OR IMPLIED POWER. The effect of borrowing beyond the express or implied power of the company is as follows—

- (1) The borrowing will be void ;
- (2) The security itself will be void ; and
- (3) The lender cannot sue the company for the return of the loan.

One of the following remedies may, however, be open to the lender—

(a) If the money paid under the loan has not been spent he can get an injunction restraining the company from parting with it.

(b) He may have an action against the directors for breach of warranty of authority.

(c) If the money has been used for payment of debts which could have been enforced against the company, the lender is subrogated to the rights of the creditors who have been paid off, and may in this case sue the company. This does not, however, give the lender the same priorities which these creditors may have enjoyed over the other creditors of the company, e.g. if a preferential creditor be paid off, the lender will not become by such payment a preferential creditor.

EXERCISE OF POWER TO BORROW. The regulations of the company will provide whether the power to borrow is to be exercised by the company in general meeting or whether the power shall be vested in the directors.

A company cannot exercise its power to borrow until it is entitled to commence business and has obtained the trading certificate required under Sec. 87 of the Act, dealt with on page 89. This provision does not apply to private companies, which may exercise their power as soon as they are incorporated.

PROPERTY CAPABLE OF BEING PLEDGED. A company may pledge the whole of its property and undertaking, both present and future, as security for loans, where it has an express or implied power to borrow but, if it desires to pledge its uncalled capital, it should have express power in its Memorandum or Articles, and in order to avoid any doubt the power should be definitely worded, as the following powers have been held not to include uncalled capital—

(1) "To borrow on the funds or property of the company."

(2) "To pledge, mortgage, or charge the works, hereditaments, plant, property, and effects of the company."

(3) "To mortgage or charge the property of the company."

The uncalled capital cannot, however, be pledged under any circumstances where it has been specially earmarked as reserve capital under Sec. 59 of the Act, and power taken to pledge it would be void.

The books of the company, with the exception of the statutory books, may also be pledged.

## DEBENTURES

Debentures are by far the most common documents dealing with loanable capital now in use in company matters, yet the ignorance of the average business man as to the nature of these instruments is, to say the least of it, surprising.

The layman usually confuses debentures with debenture stock, and fails to distinguish between the instrument itself and the loan it deals with.

### The Nature of Debentures.

A debenture is a mere acknowledgment of indebtedness given under the seal of the company containing a contract for the repayment of a principal sum at a specified date, and for the payment of interest (usually half-yearly) at a fixed rate per cent until the principal sum is repaid, and may or may not give a charge on the assets of the company as security for the loan.

Many forms of debenture exist, and the term is somewhat loosely applied in business, but the following observations should be read in conjunction with the foregoing definition—

(1) A debenture, as a rule, is one of a series which are expressed to rank *pari passu* with each other as to any charge given by the debenture, but a single debenture may be issued.

If the debentures of a series are not made to rank *pari passu* they would rank according to the date of issue or if issued on the same day, in numerical order.

The company cannot create new series of debentures to rank *pari passu* with the old unless the right has been specifically reserved.

(2) Debentures are not confined to companies, but clubs very often issue them, and there are cases on record of debentures being issued by individuals. In this last case, however, it would be difficult to draw the line between a debenture and a bill of sale.

(3) As a rule the debenture issued by a company is under seal, but not always. Where, however, the regulations of the company provide for the sealing of such documents they would have to be sealed to be effective.

(4) Debentures usually provide for the repayment of



the principal sum on a fixed date, usually five, ten, or twenty years after issue, or they may be repayable on demand or be irredeemable. They could always be made perpetual in the sense that there need be no fixed time for paying them off, but now by Sec. 103 of the Act they may be made irredeemable, that is to say, the debenture holder can never demand repayment.

(5) The rate of interest payable is usually specified to be at a fixed rate per cent, but it need not be so. The capital sum may carry no interest, but the debenture may be issued at a discount and the capital sum be expressed to be repaid at par or at a premium, e.g. a debenture may be issued covering £100 for £95 repayable at £105. The interest payable may also be made to vary with the profits, or provision may be made in the debenture to the effect that the interest shall only be payable out of profits.

(6) Debentures may or may not give a charge on the property, assets, or undertaking of the company. Where they do so give a charge they should always be referred to as Fixed Mortgage Debentures where the charge is fixed, and Floating Mortgage Debentures where it is not fixed. If this is adhered to much confusion and waste of time in dealing with these documents will be avoided.

(7) Debentures giving a charge on the property of the company may or may not also be secured by the creation of a trust deed vesting property in trustees upon trust, such trustees having power on the default of the company, to sell the assets and pay off the debentures.

The objects for which debentures are usually issued may then be said to be—

(a) Merely to acknowledge indebtedness ;

(b) For the purpose of securing the repayment of loans ; and

(c) To be used in payment for property purchased, services rendered, or in satisfaction of debts outstanding.

### **Debenture Stock.**

It has already been pointed out that "Debenture" is the name given to the instrument acknowledging indebtedness. "Debenture Stock," on the other hand, is the name given to the debt usually secured by debenture or by trust deed.

Lord Lindley defined debenture stock as "borrowed capital consolidated into one mass for the sake of convenience."

Sometimes debenture stock is issued without giving any charge or security on the assets whatsoever, but this is the exception.

The contract is not usually made with individual stockholders, but is made between the company and trustees for the stockholders generally, and the title of the stockholders is evidenced by stock certificates given under the seal of the company. Primarily the trustees must act on default being made by the company, but if for any reason they do not do so, the courts will uphold the equitable title of the stockholders and, upon application being made, will enforce the obligations entered into by the company.

Debenture stock is usually transferable, and the mode of transfer is similar to that described later for shares and debentures. Debenture stock may, however, be transferred in fractional amounts, but restrictions are generally placed upon this by the terms of issue, which usually provide that fractions of £1, £5, or £10 may not be transferred.

### **Form of Debentures and Debenture Stock.**

Debentures and debenture stock may be issued in the following forms—

(1) REGISTERED DEBENTURES AND DEBENTURE STOCK. In this case a register of debenture holders is kept, in which to record the names, addresses, occupations, and amounts of holding of such. This register is dealt with and written up in the same manner as the share register, which is explained on page 160. Registered debentures or debenture stock are transferred by execution of a properly stamped instrument of transfer, which may be merely in writing or by deed, the latter mode being the more usual.

(2) BEARER DEBENTURES AND DEBENTURE STOCK. The object of creating debentures in this form is to make them transferable by delivery, and to clothe them with the attributes of negotiability, as by the custom of merchants debentures to bearer are recognized in law as negotiable instruments.

Bearer debentures or debenture stock may also transfer a right for the holder to be registered, which is an advantage to a holder who prefers to have the security of registration.

### **Classification of Debentures.**

Except in the case of Naked Debentures the following applies also to debenture stock, but as such stock is invariably issued giving a first charge on the assets, naked debenture stock does not often come up for consideration, although there are a few cases on record where debenture stock has been issued without giving the stockholder any charge or security on the undertaking whatsoever. There is no doubt, however, that in the mind of the investor debenture stock is always regarded as carrying a first charge on the assets, and this distinction should be preserved by companies contemplating the issue of debentures or debenture stock.

The usual classes of debentures issued by companies are—

(1) **NAKED DEBENTURES.** Naked debentures are those which merely acknowledge, usually under the seal of the company, a debt which is unsecured. Such a debenture gives no charge or security on the assets, etc., of the company, and consequently the holders, in the event of winding-up, rank *pari passu* with the ordinary unsecured creditors, and cannot claim any priority for repayment.

The investor should clearly understand that a debt acknowledged by the issue of naked debentures is unsecured. They do, however, rank with other unsecured creditors for repayment in priority to the holders of share capital. The holders of naked debentures are also in a better position than shareholders as to return on the money invested, for interest on the capital sum covered by any class of debenture is a debt, and is consequently payable out of capital, whereas dividends on shares are not debts until they are declared, and even then can only be paid out of profits available.

(2) **FLOATING MORTGAGE DEBENTURES.** Debentures may be issued giving a floating charge on the assets and/or undertaking, both present and future, of the company as security for the loan acknowledged in the debenture.

The charge created by these debentures is only a floating charge, that is to say, that so long as the interest payments in respect of such debentures do not fall in arrear and the other conditions of their issue are duly observed, the property charged may be dealt with by the company in the ordinary course of business. The charge will not, therefore, crystallize until default is made by the company in some condition provided for in the debenture, and one or more debenture holders take steps to enforce their security, e.g. by appointment of a receiver, when the charge will become fixed.

The very nature of a floating charge is that it contemplates the continuance of the business as a going concern, and unless otherwise agreed, a floating charge retains its floating character until a receiver is appointed or a winding-up of the company commences. In the words of Lord Macnaughten in the case of *Government Stock Co. v. Manilla Rail Co.*, 1897: "A floating security is an equitable charge on the assets for the time being of a going concern; it attaches to the subject charged in the varying condition it happens to be from time to time. It is the essence of such a charge that it remains dormant until the undertaking charged ceases to be a going concern, or until the person in whose favour the charge is created intervenes. His right to intervene may, of course, be suspended by agreement. But if there is no agreement for suspension he may exercise his right whenever he pleases after default."

It is important for investors to remember that a floating debenture does not give a paramount security for—

(a) The company is free to create specific mortgages on the property charged in the floating debenture having priority over such debenture unless otherwise agreed in the terms of the issue of the floating debenture that the company shall not be at liberty to create any charge having priority over them.

Even where such a condition as the foregoing is in force there is still, nevertheless, a risk of such a prior charge being created, for, while the condition would be binding as between the company and the debenture holder, a *bona fide* purchaser for value may gain priority over the holders of floating debentures if he has obtained the legal or equitable title to any property charged before he knew of such restrictive clause contained in the debentures, even though he knew of the existence of such debentures.

(b) By Sec. 212 of the Act a floating charge created within three months of the commencement of winding-up will only be effective to the extent of the amount then actually advanced to the company with interest at 5 per cent unless the company was solvent at the time the charge was given.

(c) By Sec. 107 of the Act, if a receiver be appointed in respect of debentures secured by a floating charge or possession is taken by or on behalf of such debenture holders and the company is not in the course of winding-up, then the receiver or other person taking possession must pay out of the assets coming into his hands the debts which are by Sec. 209 of the Act preferential, in priority to the principal or interest in respect of the debentures.

(d) A floating charge will also be postponed to the rights of the following persons if they act before the debenture holders appoint a receiver or take other steps to enforce their security—

(i) A landlord who distrains for rent, but if the landlord desires to distrain after the appointment of a receiver he must apply to the court to do so.

(ii) A creditor claiming under a garnishee order where payment has actually been made before a receiver has been appointed or security enforced.

(iii) A judgment creditor if the goods are seized and sold by the sheriff before the debenture holders take steps to enforce their security, but to obtain priority over the floating charge the goods must be sold and payment made to such judgment creditor.

(3) FIXED MORTGAGE DEBENTURES. (a) *Difference between Fixed and Floating Debentures.* In the case of *Illingworth v. Houldsworth*, 1904, Lord Macnaughten distinguishes between debentures giving a fixed or specific charge on the property of the company

and those which give only a floating charge as follows—

“A specific charge, I think, is one that without more, fastens on ascertained and definite property or property capable of being ascertained and defined; a floating charge, on the other hand, is ambulatory and shifting in its nature, hovering over and so to speak floating with the property which it is intended to affect until some event occurs or some act is done which causes it to settle and fasten on the subject of the charge within its reach and grasp.”

A “fixed” charge, then, consists of an actual mortgage of the assets of the company usually to trustees for debenture holders, thereby preventing the company from creating charges in priority to the fixed charge.

The term “mortgage debentures” is often loosely used to include floating debentures, and in some cases naked debentures. Debentures which carry a fixed charge should always be referred to as “Fixed Mortgage Debentures”; where a floating charge only is given as “Floating Mortgage Debentures,” and where no charge is given merely as “Debentures.” If the investor is to be prevented from buying something which he believes to be something else it is essential that this distinction in name be preserved.

The property charged in the case of fixed mortgage debentures will usually be specifically conveyed to trustees.

(b) *Assets Charged in Mortgage Debentures.* The fixed charge is, usually, restricted to what are known as Fixed Assets, such as freehold and leasehold land and buildings, plant and machinery, rolling stock, and the like. It will be obvious that were such assets as stock in trade, cash, investments, and book debts, known as liquid or floating assets, to form part of a fixed charge the company could not carry on its business as it would not be free to deal with the commodities in which it trades. It is, therefore, invariably

the case that such liquid assets only carry a floating charge, thus leaving the company free to deal with them in the ordinary course of business.

(c) *Form of Mortgage Debentures.* Mortgage debentures, both fixed and floating, usually take one of the following forms—

(1) Those in respect of which the security is contained in a trust deed ;

(2) Those which contain the charge giving the security in themselves ; and

(3) Those secured by a trust deed and also containing a charge in the debentures themselves.

The conditions of the issue of such debentures will be endorsed on the debenture itself, and should be thoroughly understood by the investor before parting with his money.

The usual conditions endorsed on the registered debenture are summarized as follows—

(a) As to debenture being one of a series ranking *pari passu*. Also provision that company is not to create prior charges or other debentures ranking *pari passu* with the debentures now issued.

(b) As to keeping and inspection of register of debenture holders.

(c) As to transfer of the debentures.

(d) Provision with respect to joint holders.

(e) As to closing of register.

(f) Exclusion of equities. This is important, as the debenture is a chose in action and consequently, without provision being made, would only be assignable subject to any equities existing between the company and the original subscribers.

(g) Power of company to pay off on notice being given.

(h) Provision that principal moneys to become repayable immediately on default.



- (i) Reference to any trust deed.
- (j) Place at which principal moneys are repayable.
- (k) Provisions as to service of notices.
- (l) Provisions as to holding meetings of debenture holders.

Bearer debentures will contain similar provisions, but will, of course, omit those dealing with the register, transfers, and other clauses peculiar to registered debentures, and will substitute for these, provisions as to interest coupons.

### Trust Deeds.

(1) ADVANTAGES OF TRUST DEEDS. The most important advantages to be obtained from securing the debentures by the creation of a trust deed are—

(a) The legal estate in the property charged can be vested in trustees, thus avoiding the postponement of the equitable title of the debenture holders to subsequent mortgagees.

(b) The trustees can enter and sell immediately on default, and can continually watch over the interests of the debenture holders and, if necessary, force the company to keep the property charged in good condition. In the absence of trustees, valuable time is usually lost by waiting for some debenture holder to take action.

It will depend upon the financial stability of the company as to whether it is essential for an issue of debentures to have the further security of a trust deed.

The rules of the Stock Exchange as to the contents of a trust deed to be complied with where a quotation of the mortgage debentures on the Stock Exchange is desired are contained in Chapter XIII.

(2) THE DUTIES OF THE TRUSTEE. The trustees must carry out their duties under the trust deed honestly, and must not commit any breach of trust

therein contained, for they have the liability of and are in the same position as other trustees. They are appointed and their remuneration is fixed by the deed. If no provision is made in the deed for remuneration they are not entitled to any.

The usual duties of trustees of such a deed may be summarized thus—

(a) Make themselves thoroughly conversant with the terms of the deed, for they cannot escape from the consequences of a breach of trust on the grounds of ignorance of the terms of the trust deed. They must perform their duties in strict accordance with the terms of the deed.

(b) Unless the deed otherwise provides, they must act jointly.

(c) The trustees cannot delegate their authority unless the deed expressly or impliedly authorizes them to do so. They may, however, employ the following agents—

(1) Brokers to buy and sell securities.

(2) Bankers to hold trust funds.

(3) Solicitors for legal work.

(4) Accountants to keep the accounts of the trust where such accounts are complicated.

(5) Bailiffs to collect debts.

(6) Attorneys to act abroad.

The trustees must, however, be careful in their choice of such agents in order to avoid liability.

(d) They must take all steps to perfect their title to the property by registration or otherwise.

(e) They must see that the company carries out its obligations under the deed.

(f) They must not allow their private interests to come into conflict with their duty as trustees.

(g) They must go to the Court for advice where legal difficulties arise, or to obtain sanction to do any

act which under the deed they have no power to do, but which may be necessary in the interests of the debenture holders. This is done by way of an Originating Summons.

(h) When called upon they must furnish the debenture holders with information as to how the trust is being carried out.

(i) They must act with discretion not only from the point of view of the debenture holders' interests, but also with regard to the interest of the company itself.

### **Registration of Mortgages and Charges.**

(1) **REGISTERS.** Two registers are kept in which are recorded all particulars of mortgages and charges affecting the property of the company. Sec. 100 of the Act requires one of these registers to be kept by the company at its registered office. The other register is kept by the Registrar of Joint Stock Companies under Sec. 93 of the Act.

*Company's Register.* The register kept by the company must contain the following particulars—

(i) A short description of the property mortgaged or charged ;

(ii) The amount of the mortgage or charge ; and

(iii) The names of the mortgagees or persons entitled thereto (except in the case of securities to bearer).

Any director, manager, or other officer who knowingly and wilfully authorizes or permits the omission of any entry required to be made under Sec. 100 is liable to a fine not exceeding fifty pounds.

This register must not be confused with the register of debenture holders kept by the company in respect of registered holders.

A form of ruling in common use for such register of mortgages and charges is given on page 170.

*Somerset House Register.* Sec. 93 provides for the registration, with the Registrar of Joint Stock

Companies, of the prescribed particulars of the mortgage or charge, together with the instrument by which the mortgage or charge is created or evidenced, within twenty-one days after the date of its creation in respect of the following—

(a) A mortgage or charge for the purpose of securing any issue of debentures.

(b) A mortgage or charge on the uncalled share capital of the company.

(c) A mortgage or charge created or evidenced by any instrument, which, if executed by an individual, would require registration as a bill of sale.

(d) A mortgage or charge on any land wherever situated, or any interest therein.

(e) A mortgage or charge on any book debts of the company.

(f) A floating charge on the undertaking or property of the company.

Sec. 97 of the Act provides that on evidence being given to the registrar that the debt for which any registered mortgage or charge was created has been paid or satisfied, he may order that a memorandum of satisfaction be entered on the register, and if required shall furnish the company with a copy thereof.

(2) EFFECT OF NON-REGISTRATION. Failure to register in the company's register does not affect the validity of the charge although, as already stated, it renders the officers of the company responsible for such non-registration liable to a fine.

Failure to register with the Registrar of Joint Stock Companies within twenty-one days of the creation of the charge renders it void as to security, but does not affect the obligation to pay the debt, which remains. The debt would, however, in this case, only rank as unsecured, in the event of winding-up, as it is void as

to security against the liquidator and creditors of the company.

The date of creation of the debentures will depend upon whether it is a single debenture or one of a series. In the former case it would be the date the instrument was executed, in the latter case not until some of the series have been actually issued.

(3) OBJECT OF REGISTRATION. The object of the registration of such mortgages and charges is to protect persons dealing with the company, either by investment or by giving credit, for registration ensures that they are affixed with notice of charges on the assets of the company.

This publicity is a great benefit, but it is sometimes avoided by directors of companies when dealing with debentures, who fear that the knowledge of the mortgage or charge would affect the credit of the concern. Their method in such a case is to pay off the debentures by issuing fresh ones in substitution before the expiration of the twenty-one days allowed for registration, continuing the process until the final issue is registered and paid off in a short time after registration. It must be remembered, however, that—

(a) The issue of the new debentures might be held to be a fraudulent preference if winding-up takes place within three months of such issue, and the company was not solvent at the time the debentures were issued.

(b) The security will be void against the liquidator and creditors of the company if the new issue is not registered before the company goes into liquidation.

(c) Penalties may be incurred through non-registration of the previous debentures.

(d) Where the previous debentures have not been stamped, penalties may also be incurred under the Stamp Act, 1891.

This weak spot in the provisions as to registration of mortgages and charges should be remedied when the Act is overhauled.

(4) INSPECTION OF REGISTERS. The register of mortgages and charges kept by the registrar must be kept open, under Sec. 93 of the Act, to the inspection of anyone on payment of the prescribed fee, not exceeding one shilling for each inspection.

Any creditor or member of the company has the right, under Sec. 101 of the Act, to inspect free of charge copies of any instruments creating a mortgage or charge requiring registration, and the register of such charges kept by the company. Any other person may also inspect such documents and register on payment of such fee, not exceeding one shilling for each inspection, as may be prescribed by the regulations of the company. Refusal to allow such inspection renders every officer, director, or manager knowingly or wilfully permitting the refusal liable to a fine not exceeding five pounds, together with a further fine of two pounds for every day during which the refusal continues. In addition to these fines any judge of the High Court may by order compel immediate inspection of the documents or register.

The register of debenture holders kept by the company in respect of registered debentures must be kept open for the inspection of registered debenture holders and shareholders, subject to any reasonable restrictions as the company in general meeting may impose, so that at least two hours in each day are appointed for inspection. Such debenture holders and shareholders are also entitled to require a copy of this register on payment of 6d. per 100 words, and registered debenture holders are entitled also to require copies of the debenture trust deed, if any, on payment of 1s. if printed, or 6d. per 100 words if not printed.

### **Rights of Debenture Holders.**

The rights of the debenture holders will vary according as to whether the debentures are naked or carry a floating or fixed charge, and will to a large extent depend upon the conditions of issue.

Holders of naked debentures may—

(a) Sue for principal and interest due.

(b) Issue execution.

(c) Petition for a winding-up order, in which case they would prove as unsecured creditors.

Holders of floating mortgage debentures may—

(a) Exercise the power of sale and appoint a receiver under the Conveyancing Act, 1881, if the security becomes enforceable, and the debenture or the debenture trust deed contains a provision for the exercise of such power, but not otherwise.

(b) Where the terms of the Conveyancing Act, 1881, are not made to apply as above the holders of such debentures may on default being made by the company—

(1) Bring an action for declaration of charge, accounts, the appointment of a receiver, and foreclosure and sale.

(2) Present a petition for a winding-up order. This can be done even though the principal is not due where the company is insolvent, and the appointment of a receiver does not deprive them of the right to file this petition for winding-up.

Holders of a fixed mortgage debenture have the rights given to them by the trust deed which ordinarily gives power—

(a) For the trustees to enter on the property, where default is made by the company, with power to sell it and distribute the proceeds amongst the debenture holders.

(b) If the deed contains a power of sale the trustees may appoint a receiver when the occasion arises.

(c) Every holder is, as already stated, also entitled, on payment, to a copy of the trust deed.

In all cases, whether naked, floating, or fixed debentures, the debenture holders—

(i) In a public company have the right given to them by Sec. 114 of the Act to receive and inspect balance sheets, reports of directors, and auditors' reports ;

(ii) Have the right to obtain specific performance of a contract to issue debentures and now, under Sec. 105 of the Act, a contract with a company to take up and pay for any debentures of the company may also be enforced by an order for specific performance against the debenture holders.

In the case of floating and fixed mortgage debentures, the debenture or the trust deed covering the same should definitely define the rights of the holders.

### **Issue of Debentures.**

Debentures or debenture stock may be issued at par, at a premium, or, unlike shares, at a discount.

Where debentures are issued at a discount, Sec. 90 of the Act requires the full amount of such discount, or so much thereof as may not have been written off, to be stated in the balance sheet of the company until the whole amount has been written off.

The issue of debentures must not be used as a means to issue shares at a discount (*Mosely v. Koffyfontein Mines*, 1904), e.g. by making one of the terms of the issue of debentures at a discount that the holders shall be at liberty to call on the company to allot fully paid shares at par in satisfaction of the debentures.

The company's power to issue debentures ceases on a winding-up, and it cannot make any issue until it is entitled to commence business.

The provisions of the Act dealing with issue of a



prospectus, statement in lieu of prospectus, liability for statements in prospectus, apply equally to a prospectus offering debentures as to a prospectus dealing with shares. The prospectus is dealt with in this book in Chapter X.

### **Stamp Duty on Debentures.**

The stamp duty payable upon debentures or debenture stock is at the rate of 2s. 6d. per cent. The duty is not payable, however, where it is shown to the satisfaction of the Commissioners of Inland Revenue that the stamp duty payable in respect of any mortgage has been paid on any trust deed or other instrument securing the debentures to be issued.

### **Debentures Issued as Collateral Security.**

Debentures are very often issued by companies as collateral security against bank loans and overdrafts, that is to say, they can be realized by the lender only in the event of the loan, in respect of which the security is given, not being repaid according to agreement. As soon as the loan is repaid, however, the security is released.

Sec. 104 of the Act provides that such debentures shall not be deemed to have been redeemed by reason only that the account has ceased to be in debit while the debentures remained in the hands of the lender.

Such an issue of debentures should be shown in short on the liabilities side of the Balance Sheet as follows—

£5,000 6% Mortgage Debentures . . . . .	£5,000
issued as Collateral Security in respect of Bank Overdraft.	

No entries are made in the financial books, except by way of memoranda accounts, until the debentures become effective on default being made.

### Redemption of Debentures.

Debentures may be redeemed in various ways, for example, by payment out of capital, by payment out of profits, by payment out of an accumulated fund, by an issue of further debentures to pay off the old series, or by an issue of shares, and they may be redeemable on a fixed date or by annual drawings or at any time at the option of the company.

Where debentures are to be redeemed on a fixed date out of an accumulated fund the best method of providing for the redemption is by means of a sinking fund. It must be remembered that where the debentures are redeemable at a premium the payment of such premium would also have to be provided for in the sinking fund.

Under the sinking fund method the annual instalment required to produce the nominal amount of the debentures, plus any premium payable, at a specified rate of interest, will be calculated from tables. In the accounts of the company this amount will be debited annually to the Profit and Loss Appropriation Account and credited to a Debenture Redemption Fund Account, a like amount of cash will be invested at the same time in gilt-edged securities and specially earmarked for redemption of the debentures. The interest on the investments will be credited to the Debenture Redemption Fund Account, and will be invested as received; these entries being effected each year until redemption.

When the debentures are due to be redeemed the procedure will be—

(1) Realize the investments, debiting the proceeds to cash, and crediting the Investment Accounts, any profit or loss on realization being adjusted in cash.

(2) Pay off the debentures by crediting cash and debiting the Debenture Account.

(3) The accumulated profits standing to the credit of the Debenture Redemption Fund Account should then be transferred to a General Reserve Account. The object of accumulating this profit is to prevent the cash being distributed by way of dividend.

Another method of providing the cash for redemption is by taking out an endowment insurance policy to mature on the redemption date.

### Debentures in "One-Man Companies."

It is imperative that persons lending money to a new company on the security of debentures, especially where such company is what is termed a "one-man company," should ascertain not only that the company has power to pledge its property, but that the property charged has been properly conveyed to it by the vendor, and where the vendor is an individual, that at the time of the conveyance he was solvent, otherwise the debenture holder might subsequently find his security ineffective. This was so in the case of *in re Dombrowski*, 1923, where a bankrupt who was absolutely insolvent had within three months of the filing of the bankruptcy petition transferred his business to a one-man limited company; several persons being later on induced to lend money to such company on the security of debentures. The transfer of the property to the company being a fraudulent conveyance was subsequently held to be an act of bankruptcy, and consequently void; the property thus vesting in the trustee in bankruptcy under the doctrine of "relation back" deprived the debenture holders of their security.

*Re Dombrowski* is to be distinguished from the case of *in re Hirth*, 1899, although the results were similar. In the case of *in re Hirth*, the vendor effected the conveyance of his property to the company in consideration of the issue of debentures to himself in an

unsuccessful effort to obtain, in respect of his capital, priority over his own creditors. In the later case, however, the debentures were issued by the company as security for loans to third parties in good faith, such lenders having no knowledge of the fraudulent conveyance which nullified the charge contained in their debentures.

## NOTES

A method of obtaining loanable capital much in vogue in the boom year of 1920, and which has subsequently been resorted to from time to time, is by means of an issue of Notes.

There is much doubt as to the nature of these notes, and difficulty is often experienced in deciding whether they are merely in the nature of Promissory Notes or whether they are Naked Debentures.

A Promissory Note is defined by Sec. 83 of the Bills of Exchange Act, 1882, as "an unconditional promise in writing made by one person to another signed by the maker, engaging to pay, on demand or at a fixed or determinable future time, a sum certain in money to, or to the order of, a specified person or to bearer." It is also provided in the same section that a promissory note is not invalid by reason only that it contains also a pledge of collateral security with authority to sell or dispose thereof.

While some of the notes issued by companies may very well come within this definition of a Promissory Note, yet in the majority of cases the notes do not contain an unconditional promise to pay, in which case they come more within the definition of a debenture, and are practically naked debentures under a fancy name; for they seldom give any charge on the assets.

These notes are usually issued under the seal of the company, subject, as a rule, to many conditions,

acknowledging indebtedness and undertaking to repay the sums advanced on a specific date or dates, by drawings or otherwise. The holders would rank, in the event of winding-up, as unsecured creditors, as the notes do not pledge the property of the company.

The question has been raised whether a private limited company, which is precluded by the Act and its Articles from issuing shares or debentures to the public, would be allowed to issue notes to the public. It would appear that where such notes are merely promissory notes they cannot be said to be included in the term "shares or debentures," and consequently, in the opinion of the writer, there would apparently be nothing to prevent such an issue. Where, however, the term Notes is used to cover an issue of naked debentures the renaming of the debentures as notes would not take them out of the term "shares or debentures," and consequently a private limited company would be precluded from making such an issue. The whole matter is, however, one of doubt, and can only be tested in the Courts; this has not, up to the present, been done.

## CHAPTER VI

### REGISTRATION, PROFITS PRIOR TO INCORPORATION AND COMMENCEMENT OF BUSINESS

AFTER the preliminary work of the promoter, it is now necessary to effect the registration of the company.

#### **Matters Incidental to Registration.**

The promoter, having fixed the name, domicile, objects, and capitalization of the company, will now instruct his solicitor to prepare the Memorandum and Articles of Association for submission to a preliminary meeting of himself and six other potential members who sign them, and thereby become the signatories. The signatures must be attested, but one witness to all the signatures is sufficient.

The signatories must subscribe for at least one share, and, as already stated, there must be at least seven of them in the case of a public limited company, although the promoter need not necessarily be one.

The solicitor will also be instructed to proceed with the registration of the company, and at the same time, if not already done, to prepare the purchase agreement as between the company and the promoter, and a draft prospectus.

Before registration can be effected there must be produced to the Registrar of Joint Stock Companies—

(1) The Memorandum and Articles of Association signed by the seven signatories, or two in the case of private companies. These documents are dealt with in the next chapter.

(2) A list of persons who have consented to become directors.

If the first directors of a public limited company are appointed by the Articles, it will also be necessary, before registering the Articles, to produce to the Registrar—

(a) The written consent of such directors to act, signed by themselves or by their agent duly authorized in writing.

(b) The written authority of each of these directors to file this assent with the Registrar.

(3) A Statutory Declaration that the requirements of the Acts have been complied with.

This declaration should be made by a solicitor of the High Court, who has been engaged in the formation of the company, or by some other person named in the Articles as director or secretary of the company.

(4) The proper stamp duties and fees must be paid. Capital duty of £1 per cent is payable upon the nominal capital irrespective of the amount issued, in addition to which the following fees are also payable—

1. Fee stamp on Memorandum—
 

Nominal Capital not exceeding £2,000 . . . . .	£2
For every succeeding £1,000 or part not exceeding £5,000 . . . . .	£1
For every succeeding £1,000 or part from £5,000 to £100,000 . . . . .	5s.
For every succeeding £1,000 or part over £100,000 . . . . .	1s.
with a maximum fee of . . . . .	£50
2. Deed stamp on Memorandum . . . . . 10s.
3. Fee stamp on Articles of Association . . . . . 5s.
4. Deed stamp on „ „ . . . . . 10s.

## INCORPORATION

### Certificate of Incorporation.

Upon registration of the foregoing documents and payment of the duties and fees the Registrar will enter the name of the company on the register kept at Somerset House, and will issue a Certificate of Incorporation as follows—

No.....

### CERTIFICATE OF INCORPORATION

I hereby Certify that the Blank Company, Limited, is this day Incorporated under the Companies Act, 1908 to 1917, and that the Company is Limited.

Given under my hand at London this..... day of  
 ... .. One thousand nine hundred and twenty four.

Fees and Deed Stamps £ . ....

Stamp Duty on Capital £..... ..

.....

Registrar of Joint Stock Companies.

This certificate is, by Sec. 17 of the Act, conclusive evidence that all the requirements of that Act, in respect of registration and of matters precedent and incidental thereto, have been complied with, and that the Association is a company authorized to be registered and duly registered under the Companies Acts. The date of incorporation, under a new regulation, is now the date that this certificate is issued and not, as before, the date on which the capital duties were paid.

### Effect of Incorporation.

The effect of incorporation is to form the members of the company into a single body, having a distinct entity from such members, and to endow it with perpetual succession.

Incorporation does not entitle a public company to commence business, and consequently contracts entered into by it are only provisional. A private company, however, is entitled to commence business as soon as it is incorporated.

### Profits Prior to Incorporation.

The purchase agreement usually provides that the new company shall take over the business or businesses



that it is purchasing from a date prior to the date of incorporation, and that the vendors shall carry on the business as agents for the company until the date of completion of purchase, interest being paid on the purchase consideration to the vendors from the date of sale until completion.

As a company cannot earn profits before it comes into existence the profits earned prior to the date of incorporation should be capitalized, and not credited to the Profit and Loss Account, thus preventing these profits being made available for distribution by way of dividend. This is emphasized by the fact that such profits are usually allowed for when fixing the purchase consideration. The proportion of profits to be capitalized is usually arrived at either upon the basis of turnover or on a time basis calculated on the period of the first accounts, the former method being, as a rule, the more accurate.

Where, however, the purchase agreement provides that the assets of the vendors are to be taken over and paid for at a valuation on a date anterior to the date of incorporation with benefit of succeeding profits to the purchaser, such purchaser paying interest to the vendors on the purchase price from the sale date to date of completion, the agreement usually provides that the balance of such profits, after charging the interest payable to the vendors, shall be available for distribution by way of dividend.

Where profits earned prior to incorporation are capitalized, they may be utilized for writing down such intangible assets as goodwill, patents, or trade marks.

### **Adjustment of Taxation on Profits of the Year of Incorporation.**

As a rule it will be found that the business will have been assessed to tax, and probably the vendors will

have paid the same before the purchasing company takes over. As income tax is payable in advance, part of the assessment will be recoverable from the purchaser if the vendor has paid the assessment or, where not paid, the assessment will have to be adjusted between the parties. This is usually done by agreement between the parties on a time basis, otherwise the proportion will be fixed by the Commissioners of Inland Revenue under Rule 9 (2) of the rules applicable to cases I and II of Schedule D, which provides as follows—

9.—(1) If a person charged under this Schedule ceases within the year of assessment to carry on the trade, profession, or vocation in respect of which the assessment is made, and is succeeded therein by another person, the surveyor shall, within four months from the fifth day of April next after any such change, certify to the general commissioners for the division in which the assessment is made, the particulars thereof, and the full name and residence of the person charged, and of his successor and the date of the change, if the same be known to the surveyor.

(2) On receipt of the certificate the commissioners shall cause notice to be given to the respective persons of a meeting of the commissioners to consider it, and after examination of the said persons, if they attend, or on other satisfactory proof of the facts, the commissioners shall adjust the assessment by charging the successor with a fair proportion thereof from the time of his succeeding to the trade, profession, or vocation, and relieving the person originally charged from a like amount.

(3) The determination of the commissioners on any such certificate shall be final, and the sum apportioned to each such person shall be recoverable from him in like manner as if he had been charged under the original assessment.

(4) If either of the said persons has paid in respect of an assessment so certified more than the proportion which appears by the determination of the commissioners to be chargeable on him, the amount overpaid shall, when recovered from the person liable, be paid to the person by whom the overpayment was made.

The new company may, however, have a claim for specific cause under Rule 11, Cases I and II, Schedule D, in which case it would be entitled to be assessed on the actual profits of the first year of assessment.

## COMMENCEMENT OF BUSINESS

**Restrictions on Commencement of Business.**

The company is now in existence but, as already stated, a public company cannot commence business until the provisions of Sec. 87 of the Act have been complied with and contracts entered into by the company after incorporation, but before it is entitled to commence business, are provisional only, and are not binding upon the company until it is so entitled. Apparently the other parties to such contracts would be bound.

Sec. 87 of the Act provides that a public company cannot commence business or exercise borrowing powers unless—

(1) Shares, held for full cash consideration, have been allotted to an amount not less than the minimum subscription; this as will be seen later, is the minimum amount, fixed by the Articles, upon the subscription of which the directors may proceed to allotment;

(2) Every director has paid to the company on each of the shares taken or contracted to be taken by him, and for which he is liable to pay in cash, an amount equal to the amount payable by the subscribing public on application and allotment;

(3) There has been filed with the Registrar a Statutory Declaration, by the secretary, or one of the directors, that the aforesaid conditions have been complied with; and

(4) If there is no prospectus, then a "Statement in lieu of Prospectus" has been filed.

It is specially provided that nothing in this section is to prevent the simultaneous offer for subscription of shares and debentures, and there is a penalty of £50 a day upon every person who is responsible for any contravention of the provisions of the section.

The provisions of Sec. 87 do not apply to private limited companies, and they can, therefore, commence business as soon as incorporated, but any company, whether private or public, must commence business within a year of its incorporation, otherwise it is liable to be wound up or struck off the register.

### Trading Certificate.

When the provisions of Sec. 87 of the Act have been complied with the Registrar will issue a certificate, known as the trading certificate, certifying that the company is entitled to commence business.

The form of the trading certificate is as follows—

No.....

CERTIFICATE under Sec. 87 (2) of the Companies (Consolidation) Act, 1908 (8 Edw. 7, c. 69) that a company is entitled to commence business.

I HEREBY CERTIFY that the Blank Company, Limited, which was incorporated under the Companies Acts, 1908 to 1917, on the ... day of ..... 192., and which has this day filed a statutory declaration in the prescribed form that the conditions of Sec. 87—1 (a) and (b) of the Companies (Consolidation) Act, 1908, have been complied with, is entitled to commence business.

Given under my hand at London this ... day of ..... One thousand Nine Hundred and Twenty .....

.....  
Registrar of Joint Stock Companies.

This certificate, when issued, is conclusive evidence that the company is so entitled to commence business, and by a curious anomaly becomes effective as from the date of the incorporation of the company.

## CHAPTER VII

### MEMORANDUM AND ARTICLES OF ASSOCIATION

EVERY member of the company is entitled, under Sec. 18 of the Act, to be supplied by the company on request of the member with a copy of the Memorandum and Articles of Association on payment of such sum as may be prescribed in the Articles not exceeding 1s. The penalty on the company for refusal to comply with the request is a fine not exceeding £5 for each offence.

It would be a benefit if this privilege were extended to persons other than members when investors would then be able to ascertain vital information as to the powers of the directors, etc., without being put to the trouble of inspecting the file at Somerset House.

### MEMORANDUM OF ASSOCIATION

The Memorandum of Association is a most important document, as it is in the nature of a contract between the company and members of the outside world dealing with it. It not only defines the powers and activities of the company but limits them.

Sec. 3 of the Act provides that in the case of a company limited by shares—

3.—(1) The memorandum must state—

(i) The name of the company, with “ Limited ” as the last word in its name.

(ii) The part of the United Kingdom, whether England, Scotland, or Ireland, in which the registered office of the company is to be situate.

(iii) The objects of the company.

(iv) That the liability of members is limited.

(v) The amount of share capital with which the company proposes to be registered, and the division thereof into shares of a fixed amount.

(2) No subscriber to the memorandum may take less than one share.

(3) Each subscriber must write opposite to his name the number of shares he takes.

The clauses in the Memorandum complying with this section are usually referred to as the Name, Domicile, Objects, Limited Liability, Capital, and Association clauses respectively.

### **The Name of the Company.**

(a) CHOICE OF NAME. The name of the company is generally fixed by the promoter, although theoretically it is fixed by the subscribers to the Memorandum.

It is usual to choose a name giving some indication of the company's business, e.g. Coal Products Ltd., but any name may be chosen subject to the following restrictions—

(1) The last word of the name must be "Limited" which may be abbreviated to Ltd., or Ld., the former abbreviation being the more usual. The object of this stipulation is to ensure that persons dealing with the company have notice that the liability of the members is limited. Any contracts entered into by the company's agents without the use of this word in the name would render the agent personally liable on the contract.

Companies formed for the purpose of promoting art, science, religion, or the like, which do not purpose paying dividends, but to use all the profits for carrying on the activities of the concern may register a name without the word "Limited" as part thereof, but in order to do so they must make application for a special licence from the Board of Trade. Such licence is revocable, and companies of this class cannot hold more than two acres of land without the written consent of the Board of Trade.

(2) Words such as "royal" or "imperial" or the

like, indicating connection with the Crown or the Government, cannot be used without the written authority of the Home Secretary.

It is a curious anomaly, however, that at present there are no restrictions in the use of the words "British" or "National," although, as will be seen later, legislation is being introduced to strengthen the hand of the Registrar of Joint Stock Companies in respect to this.

(3) Sec. 8 of the Act provides that the name must not be the same as that of any other existing company, or so nearly resemble it as to be calculated to lead persons dealing with the company to believe they are dealing with some other company with a similar name and carrying on a similar business, unless the existing company is in course of being dissolved, and signifies its consent to the use of its name in such manner as the Registrar requires.

The rights of a partnership or individual in such a case would also be protected by the Courts by injunction in proper cases.

(b) MISLEADING NAMES. The unscrupulous promoter usually fixes his choice on some high sounding "catch penny" name calculated to mislead the public. It therefore behoves the investor to be careful of such concerns. It will be seen, however, from the following interesting questions raised and answers given in the House of Commons on the 22nd July, 1924, that legislation further regulating the choice of name is about to be introduced incorporating the recommendations of Lord Wrenbury's Commission of 1918—

Mr. A. M. Samuel asked the Secretary for Scotland whether he was aware that a trading company incorporated under the Companies Acts and calling itself the Scottish National Trust Co. Ltd., was inviting subscriptions from the public; would he state in what

respect the company was national, and, if it was not a national trust, would he either request or compel the promoters of the concern to delete the word "National" from the title of the company, so that no misunderstanding by investors might arise?

Mr. Webb (President of the Board of Trade) replied : The answer to the first part of the question is in the affirmative. Under the provisions of the Companies Acts the Registrar has no power to refuse to register a company on the ground that the word "National" is included in its title, but the question whether greater powers should be conferred on the Registrar has already been noted for consideration when the next revision of the Companies Acts is undertaken.

Mr. Samuel : Is the right hon. gentleman not aware that the case of misleading titles was dealt with by Lord Wrenbury's Commission in 1918, and has he not power to put that recommendation into operation?

Mr. Hannon : Is it not the fact that the words "National" and "Imperial" are employed by unscrupulous speculators in this country, and will he take steps to stop it?

Mr. Webb : It is quite true the report of that Commission was made in 1918, but no steps were taken during succeeding years to carry it into legislation. The result is that the Board of Trade finds itself without power to take action.

Mr. Remer asked the President of the Board of Trade whether his attention has been drawn to the misleading name adopted by the firm known as British Progress, Ltd., of which eight-ninths of the ordinary shares are held by an unnaturalized Russian, who is one of three directors, the second director being a naturalized British subject of Lithuanian origin, and the third an unnaturalized United States citizen of Russian origin; and whether he proposes to take



action under Sec. 14 of the Registration of Business Names Act of 1916, or otherwise.

Mr. Webb: The answer to the first part of the question is in the affirmative. Sec. 14 of the Registration of Business Names Act, 1916, does not apply to companies registered under the Companies Acts, nor has the Board of Trade any power to take action in a case of this kind, but the Company Law Amendment Committee, under the chairmanship of Lord Wrenbury have made recommendations in their report, with a view to conferring additional powers on the Registrar, and these recommendations will be considered when the next revision of the Companies Acts is undertaken.

(c) PUBLICITY GIVEN TO NAME. Sec. 63 of the Act provides that the name of the company, including the word "Limited," must be painted up or affixed to the outside of every office or place of business of the company in a conspicuous position and easily legible under a penalty of five pounds a day during default.

The name must also be placed on all cheques, notices, advertisements, invoices, etc., of the company under penalty of fifty pounds and personal liability on the part of the person signing in the case of cheques if the company does not pay.

(d) ALTERATION OF NAME. The company may alter its name, after registration, by special resolution with the written consent of the Board of Trade.

Where, however, a company inadvertently registers a name similar to that of an existing company it may be changed with the sanction of the Registrar of Joint Stock Companies.

Sec. 8 (4) provides that where a company changes its name the registrar shall enter the new name on the register in place of the former, and shall issue a certificate of incorporation altered to meet the circumstances of the case.

Sec. 8 (5) provides that the change of name shall not affect any rights or obligations of the company or render defective any legal proceedings by or against the company, and any legal proceedings that might have been continued or commenced against it by its former name may be continued or commenced against it by its new name.

### **Domicile and Registered Office of the Company.**

The part of the United Kingdom in which the registered offices of the company are situated, that is, whether in England (which includes Wales), Scotland, or Ireland, must be stated. A company having its registered offices in the Free State of Ireland will now, however, be treated as a foreign company, and will consequently have to comply with the provisions of Sec. 274 of the Act, which are set out on page 4.

The actual address of the registered office is not stated in the Memorandum, but notice of its situation or any change therein must be registered with the Registrar, the fee for which is 5s. This address may be freely changed from time to time, provided it is within the limits of the domicile of the company as fixed by the Memorandum, but the domicile itself can only be altered by special Act of Parliament or by reconstruction of the company. Sec. 116 of the Act provides that documents may be served on the company by leaving them at or sending them by post to the registered office of the company, and Sec. 285 of the Act defines a document as including summons, notice, order, and other legal process.

### **The Objects of the Company.**

(a) POWERS CONTAINED IN THE OBJECTS CLAUSE.  
Clause 3 of the Memorandum must detail the objects of

the company's being. The activities of the company are restricted by this clause, and it has no power to do anything outside the powers therein contained, except in so far as it is given power by statute or the power is contained in some other clause of the Memorandum.

The prevailing practice, therefore, is for the subscribers to the Memorandum to ensure that this clause is made as wide as possible so that the company may not lack power to do that which it may at any future time desire to do. To such an extent has the widening of the objects clause been carried that many companies have power to do almost everything under the sun, so much so, that it is often a difficult matter to discover the main object of the company's existence. A general power, however, taken "to do all or any other things" would be ineffective, but power may be taken to do any other things fairly incidental to the main object of the business. It must be remembered, however, that what the company considers fairly incidental and what the Courts so consider may be two very different things. It is therefore wise to frame this clause carefully, so that no room is left for subsequent doubt.

The objects of the company must not be illegal, that is to say, they must not take power to do that which the Act or the general laws of the kingdom prohibit. For example, power cannot be taken by the company to issue shares at a discount or to buy its own shares or to carry on a gambling business or to do any act contrary to public policy.

Any act done by the directors outside the powers contained in the Memorandum cannot be ratified by the company even if every member agrees, as it is *ultra vires* the company, and amounts to an alteration of the Memorandum without the consent of the Court.

Where, however, the directors act within the powers of the Memorandum but outside their own powers, the company can ratify the act so as to relieve the directors from liability, or if the act itself were *ultra vires* the Articles but *intra vires* the Memorandum, the matter could be remedied by a special resolution of the company altering the Articles.

When the company's main object has gone the company must be wound up, but it may carry on any business which is fairly incidental to its main object.

(b) ALTERATION OF OBJECTS CLAUSE. While inconvenience may be caused to some companies yet, in the main, it is all to the good that the objects clause of the Memorandum cannot readily be altered, otherwise money subscribed for a specific purpose might be applied to anything but to the furthering of that purpose. Consequently the objects clause can be altered, otherwise than by reconstruction of the company, only in accordance with Sec. 9 of the Act, which provides that a company may alter its Memorandum, with respect to the objects of the company, by special resolution, so far as to enable it—

- (1) To carry on its business more economically or efficiently ; or
- (2) To attain its main purpose by new and improved methods ; or
- (3) To enlarge or change the local area of its operations ; or
- (4) To carry on some business which under existing circumstances may conveniently or advantageously be combined with the business of the company ; or
- (5) To restrict or abandon any of the objects specified in the Memorandum.

The alteration is required to be carried out by special resolution, which does not become effective until it is sanctioned by the Court.

Before giving its sanction the Court will have to be satisfied—

(1) That sufficient notice has been given to debenture holders in the company and to every person or class of persons whose interests will, in the opinion of the Court, be affected by the alteration ; and

(2) In the case of an objecting creditor whom the Court considers entitled to object, and who has signified his objection in the manner directed by the Court, that his consent has been obtained or his debt has been discharged or secured to the satisfaction of the Court.

The Court may confirm the resolution in whole or in part, but would not allow the main object of the company to be substituted for another.

### **Limited Liability Clause.**

(a) MEMBERS' LIABILITY. Companies may be registered under the Acts with unlimited liability, but where it is intended to limit the liability of the members, a statement to that effect must be contained in clause 4 of the Memorandum. The limitation may be by shares, in which case the liability of the members is limited to the nominal amount of the shares, and will be discharged by payment for the shares in full or by transfer of the shares, or the limitation may be by guarantee or partly by shares and partly by guarantee.

When a holder transfers his shares, his transferee, when registered, becomes liable to pay any further sums due on the shares transferred, but the holder remains liable until the transferee is so registered, although he has a right to be indemnified by the transferee in respect of calls made after the transfer has been executed, but before it is registered.

A person who ceases to be a member, by transfer, forfeiture, or surrender, has a secondary liability in the event of a winding-up commencing within

one year after he ceases to be a member, for he remains liable to be placed on the " B " list of contributories, under Sec. 123, where the transferee is unable to satisfy any amount unpaid on the shares, and there are liabilities remaining unpaid which existed when he was a member, but the " A " list of contributories must be exhausted before the " B " contributories can be called upon to pay.

The object of this secondary liability is to prevent the practice frequently indulged in, prior to the passing of the Act, by unscrupulous persons who transferred their shares to paupers as a gift, in order to escape an uncalled liability on the shares, when the company was about to be wound up.

The debt due from members of a company in England or Ireland under the Memorandum or Articles is by Sec. 14 (2) a specialty debt, and will not, therefore, become statute barred until the expiration of twenty years.

(b) EXTENSION OF MEMBERS' LIABILITY. There appears to be no provision in the Act for extending the liability of members generally, other than by Reduction of Capital, Reconstruction or Compromise, but in the following cases the liability of certain members may be unlimited—

(1) Under Sec. 115 of the Act, where a company carries on business for more than six months after the number of its members has fallen below the statutory minimum (two in the case of a private company, and seven in the case of a public company), those members who knew of this position have unlimited liability in respect of debts contracted after the expiration of the six months ; and

(2) Under Sec. 61 of the Act the liability of directors or managers may be made unlimited, for the company, if authorized by its Articles, may by special resolution

alter its Memorandum to that effect, or a provision for the alteration may be made in the Memorandum as originally framed.

### Capital Clause.

(a) NOMINAL CAPITAL. The amount of the Nominal Capital of the company and the number and value of the shares into which it is divided must be stated in Clause 5 of the Memorandum. This amount is the sum upon which the Capital Duty is payable.

It is also usual to distinguish the different classes of shares in this clause of the Memorandum, but this is not necessary, as the different classes of shares and the rights attaching to them can be left to be defined in the Articles.

The object of defining the rights in the Memorandum is to strengthen the position of the holders, as the rights are not then so easily altered as when fixed by the Articles.

Where the power to create different classes of shares is taken neither in the Memorandum nor in the Articles, the company can issue shares with separate rights by altering the Articles to that effect by Special Resolution. Until the case of *Andrews v. Gas Meter Co.*, 1896, was decided to the above effect it was thought that silence in the Memorandum amounted to equality in the rights of the shareholders, and that such rights were unalterable, but, as already stated, this case decided otherwise, and Sec. 45 of the Act now gives statutory power to effect such alteration.

(b) VARIATION OF CAPITAL CLAUSE. The Capital Clause may be altered as provided by the Memorandum itself, or as provided by the Act. That is to say, the capital may be increased, reduced, consolidated, subdivided, or cancelled in the manner prescribed by Sec. 41 and Secs. 44 to 55 of the Act, and the rights

of the shareholders can be varied as provided by the Memorandum or, in the absence of any such provision, under Secs. 45 and 120 of the Act.

(c) INCREASE OF NOMINAL CAPITAL. The Articles usually provide the method by which the capital may be increased, that is, whether by ordinary, special, or extraordinary resolution, as the case may be, or the power to increase may be left, by the Articles, to the directors. Where the Articles give this power to increase, the company may increase its capital accordingly. The power must, however, be contained in the Articles, and where this is not so any clause in the Memorandum purporting to give the power will in itself be ineffective.

If the Articles do not give power to increase the capital, the company may take power and also exercise it by one Special Resolution. Table "A," however, requires an extraordinary resolution for the purpose in the case of companies working thereunder.

Notice of any increase in the Nominal Capital must be given to the Registrar within fifteen days after the increase was resolved or took place, under a penalty of £5 a day on the company, and every director and manager who knowingly or wilfully authorizes or permits default, and 5 per cent interest will also be chargeable on the capital duty.

The capital duty of £1 per cent must also be paid on the increased amount of capital. Where, however, an increase of capital takes place simultaneously with a reduction of capital of like amount the payment of the duty on the increased capital is not required. This is a concession made by the Inland Revenue, which is not taken advantage of to the full extent by companies as the arrangement is little known. It must be borne in mind that two points are essential to the concession, namely—



(1) The provision for subsequently increasing the capital must be made at the same time as the proposal for reducing it ; and

(2) If the capital is increased to a figure higher than that by which it has been reduced, duty will be payable on the net increase.

The registration fees will, however, be payable in any case.

It is only reasonable that some such concession should be made, as duty paid is not repayable upon the amount by which the capital may be subsequently reduced.

A knowledge of this arrangement may save a considerable sum in capital duty.

The foregoing provisions do not apply at all to an increase of the paid-up capital of the company, which can be increased by the directors who make calls as and when the further capital is required.

(d) REDUCTION OF CAPITAL. (1) *Procedure.* A company may only reduce its capital as provided by Secs. 46 to 55 of the Act, and cannot take power to reduce it in any other way.

Sec. 46 of the Act provides as follows—

46.—(1) Subject to confirmation by the court, a company limited by shares, if so authorized by its articles, may by special resolution reduce its share capital in any way, and in particular (without prejudice to the generality of the foregoing power) may—

(a) Extinguish or reduce the liability on any of its shares in respect of share capital not paid up ; or

(b) Either with or without extinguishing or reducing liability on any of its shares, cancel any paid-up share capital which is lost or unrepresented by available assets ; or

(c) Either with or without extinguishing or reducing liability on any of its shares, pay off any paid-up share capital which is in excess of the wants of the company, and may, if and so far as is necessary, alter its memorandum by reducing the amount of its share capital and of its shares accordingly.

(2) A special resolution under this section is in this Act called a resolution for reducing share capital.

Where the Articles already give power to reduce the capital a special resolution will be necessary to exercise that power. If the Articles do not give this power, unlike an increase in capital, two special resolutions will be necessary to effect the reduction, one resolution to take power and the other to exercise the power when taken.

The sanction of the Court to the reduction is then necessary, and will be petitioned for under Sec. 47 of the Act as soon as the required special resolution or resolutions have been passed. Where the rights of creditors do not intervene the order of the Court confirming the reduction can be obtained in from two to three weeks, but where the interests of creditors are affected by the scheme, as where a repayment of paid-up capital or the cancellation of liability on uncalled capital is involved, it will take considerably longer, usually about seven or eight months, before the order can be made. Care should be taken to avoid making application at a time near a vacation if the matter requires expedition.

Before giving its sanction to the scheme the Court will have to be satisfied as to the following—

(1) Where the rights of creditors are not concerned it will consider—

(i) How the interests of the public who are afterwards induced to take shares may be affected ; and

(ii) Whether the reduction is fair and equitable as between the different classes of shareholders, e.g. where there are preference shares which have no preference as to capital, sanction would not be given to a scheme reducing the ordinary shares without a similar reduction in the preference shares.

(2) Where the proposed reduction involves either the diminution of liability in respect of uncalled share capital or the payment to any shareholder of any

paid-up capital, that the consent of the creditors has been obtained or the debts due to objecting creditors have been paid or secured to the satisfaction of the Court.

It does not now appear to be necessary to show the Court that the capital has been lost or is unrepresented by available assets, though in the case of *in re Tarapaca & Tocopilla Nitrate Co., Ltd.* (Ch. Div. 1917) it was decided that a petition for the reduction of the capital of the company must show that the capital proposed to be paid off was in excess of the wants of the company.

The words "and reduced" must be added to the name of the company after the word "Limited," for such period as the Court may fix. These words must be used on and from the date of the confirmation, by the company, of the resolution for reducing the share capital, where the rights of creditors intervene; and on and from the date of the presentation of the petition to the Court for confirming the reduction where the rights of creditors are not affected, that is to say, where the reduction does not involve either the diminution of any liability in respect of unpaid share capital or the payment to any shareholder of any paid-up capital. The Court may, however, in this latter case, dispense altogether with the use of the words. The usual time fixed by the Court during which these words are to be used as part of the name of the company is from one to two months, but if there has been anything doubtful about the scheme or anything extraordinary in the management of the company or for any other reason the Court thinks fit, a much longer period may be fixed. The object of the use of the words "and reduced" is to notify persons dealing with the company that its status has been altered.

Another protection to potential creditors and others is contained in Sec. 55 of the Act, under which the

Court may require the company to publish, as the Court directs, not only the reasons for reduction, but any other information in regard thereto which the Court may think expedient with a view to giving proper information to the public. The Court may also require the causes which led to the reduction being likewise published.

The Order of the Court must be advertised, and will not become effective until it has been registered with the Registrar of Joint Stock Companies.

It will be necessary to call in the share certificates and either issue new ones or endorse those called in with particulars of the reduction by means of a rubber stamp. The former method is preferable. The reduction will be recorded in the books by debiting the Share Capital Account or accounts concerned, and crediting a Capital Reduction Account, which account will then be debited with amounts written off the assets, and the various asset accounts will be credited.

In the following cases of reduction of capital neither the sanction of the Court nor, necessarily, a special resolution of the company is required, but each case must be carried out in conformity with the Articles of the company—

(i) To forfeit shares for non-payment of calls where power to forfeit is given by the Articles.

(ii) To accept a surrender of shares as a short cut to forfeiture where the right to forfeit has already arisen.

(iii) To cancel shares which have never been taken or agreed to be taken.

(iv) To return accumulated profits in reduction of paid-up capital, such capital remaining liable to be called up again. Sec. 40 of the Act requires this reduction to be made by special resolution. This section also provides that any shareholder may, within one month of the passing of such a resolution, require

the company to retain the cash repayable to him and invest it in authorized securities. Such amounts retained must be stated in the Annual List and Summary. The object of this provision is to leave the shareholders with no liability on the shares, the amount retained being available to meet future calls. The interest received by the company from such authorized investments must be paid over to the shareholders concerned.

The amount of any undivided profits returned to shareholders under Sec. 40 must be specified in any statement of accounts laid before the company in general meeting.

(2) *Effect of Reduction on Rights of Shareholders.* The rights of the different classes of shareholders must, as far as possible, be preserved if the scheme of capital reduction is to meet with the approval of the shareholders generally, for one class nearly always, no matter how favourable the conditions of reduction, considers itself ill-treated under the scheme.

Where cumulative preference shareholders are called upon, under the scheme, to surrender their claim to arrears of dividend in consideration of the ordinary share capital being reduced they should be given some *quid pro quo* in respect of the sacrifice they make. Where preference shares have a preference as to return of capital and are cumulative as to dividend, the reduction of the ordinary capital is no compensation to the preference shareholders who are called upon to sacrifice arrears of dividend, because the reduction of the ordinary share capital is merely a book-keeping entry, and does not, in such a case, affect their rights in the least degree, as they will still be entitled to surplus profits and to surplus capital in the event of winding-up.

Reduction schemes of late have tended to act more

against the preference shareholder than against the holders of ordinary shares, and the following extract which appeared in the issue of *The Financial Times* of the 19th July, 1924, over the initials of F. D. H., gives vent to the feelings of such shareholders—

When there's a melon to divide,  
 Me they remember not :  
 The Ordinary Shareholders decide  
 And take the blessed lot !  
 That rare and most refreshing fruit  
 In shape of L.S.D.  
 The Ordinary Shareholders loot—  
 They don't remember me.

When things go ill and slumps attack  
 Our little garden plot,  
 The Ordinary holders hack  
 And hoe and make it hot :  
 They cut down here and lop off there  
 To save the L.S.D.  
 As I've a Preferential share,  
 Well, they begin with me.

It must, however, be remembered that were it not for a reduction of the ordinary capital the preference shareholders would not or might not receive the dividends in the future which such a reduction makes available to them. On the other hand, as far as the ordinary shareholders are concerned it does not really matter to what figure the nominal value of the share is reduced, for they still have the same interest in the profits and capital of the company, unless the scheme of reduction gives some compensation to preference shareholders either by way of an increased fixed dividend or by issuing to them, under the scheme, ordinary shares as compensation for arrears of preference dividends or by giving them participating rights in addition to their right to a fixed dividend.

Where the preference shareholders rank *pari passu*

with ordinary shareholders as to the return of capital in a winding-up a reduction of ordinary capital should not be made without an equal reduction in preference capital, otherwise the rights of the ordinary shareholders in the capital of the company would be materially reduced to the benefit of the preference shareholders.

No set scheme of capital reduction can be laid down owing to the varying conditions necessitating the reduction, but the scheme should be drawn up carefully and only put forward after full consideration has been given to the effect it will have upon the rights of the different classes of shareholders.

Where possible, it is advisable to submit the scheme to the principal shareholders of the classes affected in order to ensure their support thereto.

(e) CONSOLIDATION AND SUB-DIVISION OF SHARES. In addition to the power to alter its capital by increase under Sec. 41, and by reduction under Sec. 46, a company may also, if so authorized by its Articles, alter it under Sec. 41 of the Act as follows—

(1) By consolidating or dividing any of its share capital into shares of larger amount than its existing shares, e.g. by issuing a £1 share for every twenty 1s. shares held or a £5 share for every five £1 shares held.

In view of what has already been stated in this book as to the marketability of shares of high nominal value, this power is very rarely exercised by companies. The resolution necessary to exercise the power will usually be fixed by the Articles, but where this has not been done the power can be taken and exercised by one special resolution.

An alteration under this power would necessitate renumbering the shares, and the issue of new share certificates.

(2) By converting all or any of its paid-up shares

into stock and re-converting such stock into paid-up shares.

Stock can only be issued in respect of fully paid shares, and cannot therefore be issued direct to the public in that form. This provision is got over by making it a condition of the issue of shares that the same shall be converted into stock as soon as fully paid. It is difficult to see why such a provision is necessary.

The procedure on the conversion of shares into stock is fully dealt with on page 49.

(3) By subdividing its shares, or any of them, into shares of smaller amount, e.g. the sub-division of a £1 share into five shares of 4s. each, or twenty shares of 1s. each. The proportions unpaid on the subdivided shares must, however, remain the same as before the sub-division took effect. That is to say, a £1 share credited with 10s. paid can be converted, in the cases mentioned above, only into five shares of 4s. each, credited with 2s. each paid, or twenty shares of 1s. each credited with 6d. each paid. An assessment on shareholders cannot, therefore, be made under this provision.

The Act requires this alteration to be made by a special resolution, and consequently if the Articles do not contain power to make the alteration, two special resolutions are necessary, one to take power, and the other to exercise it. It is difficult to see why a special resolution should be necessary in this case, and not be necessary in the reverse operation of consolidation. The fact that before the passing of this Act it was illegal to subdivide shares may have some bearing on the anomaly.

The shares will have to be renumbered, and new share certificates issued upon the subdivisions becoming effective.



(4) By cancelling shares which, at the date of the resolution in that behalf, have not been taken or agreed to be taken by any person, and by diminishing the amount of its share capital by the amount of the shares so cancelled.

The object of this provision is to enable the company to reduce its unissued nominal capital without having recourse to the Courts under Sec. 46.

It is difficult, however, to imagine a case where a company would desire to cancel such capital, especially where the capital duties have been paid.

It is expressly provided in the Act that this cancellation of shares shall not be considered as a reduction of capital.

The method of cancellation will be fixed by the Articles, but if it is not so fixed only one special resolution is necessary to take power, and also exercise it.

Any copy of the Memorandum issued after the date an alteration in the capital, made under Sec. 41 of the Act, takes effect must incorporate such alterations. Notice must also be given to the Registrar of Joint Stock Companies.

The rights of consolidation and subdivision of shares under this section must not be confused with the power to consolidate and subdivide shares of or into shares of different classes under Sec. 45 of the Act. Under Sec. 41 the rights of the shareholders after alteration of the capital remain the same as before, but under Sec. 45 the rights may be altered.

(f) REORGANIZATION OF SHARE CAPITAL. (1) *Sec. 45.* Alteration in the rights attaching to the different classes of share capital, where the priorities are stated in the Memorandum, could always be effected if the Memorandum also gave power to make the alteration, in which case the mode of alteration would also be prescribed either in the Memorandum itself or in the

Articles, and would not require the sanction of the Court. If, however, the Memorandum gave no power to alter the rights, they could not be altered. Now, however, where the priorities are fixed by the Memorandum with no expressed power to alter, the capital can be reorganized under Sec. 45 of the Act, which gives power to consolidate different classes of shares, or to divide shares into different classes by special resolution, confirmed by the Court. The privileges attaching to any special class of share, however, can be interfered with only by a resolution passed by a majority in number of the shareholders of the class or classes whose rights are affected, and who hold three-fourths of the share capital of that class. This resolution must then be confirmed by one passed by a simple numerical majority of the same class or classes present in person or by proxy at a subsequent meeting. That is to say, the resolution must be confirmed in the same manner as a special resolution.

A resolution so passed when confirmed by the Court is binding on all the shareholders of the class.

Where an Order of the Court is made under this section an office copy thereof must be filed with the Registrar of Companies within seven days after the making of the order, or within such further time as the Court may allow, and the resolution will not be effective until such a copy has been so filed.

Sec. 45 only applies to a reorganization of the capital by consolidation or division of shares of or into shares of different classes, and not to a modification of the rights of a particular class which latter should be carried out under Sec. 120.

It is a matter of some difficulty to get such a resolution through, as a majority of three-fourths in value as well as a majority in number must be present in person or by proxy when the resolution is passed, that

is to say, it must be passed by the requisite majority of the class affected, and not merely of those present at the meeting. The degree of difficulty will, however, be determined by the amount of compensation, if any, offered to the class of shareholders whose rights it is proposed to modify, as such shareholders are entitled to, and usually demand, some *quid pro quo*.

(2) *Sec. 120.* A modification of the rights of a particular class of shareholders, not involving a reorganization of the capital of the company by consolidation of shares of different classes or by division of particular shares into shares of different classes, can be carried out under Sec. 120 of the Act, but in this case the permission of the Court must be first obtained to hold the meeting, and after the resolution has been passed by a majority in number amounting to three-fourths in value of the members present in person or by proxy at the meeting, the sanction of the Court must be obtained to the scheme.

No confirmatory meeting is required to be held under this section, but the company must go to the Court twice.

Compromises or arrangements with creditors may also be made under Sec. 120, and any scheme passed by the requisite majority of members or creditors, when sanctioned by the Court, will bind the members, creditors, and the company. No arrangement can, however, be made under this section purporting to deprive dissentient shareholders of their rights under Sec. 192.

(g) *RECONSTRUCTION.* Once the resolutions under Sec. 45 and 120 of the Act have been passed and confirmed by the Court, all the shareholders are bound to the terms of such reorganization. This is not the case, however, where the procedure has been by way of reconstruction under Sec. 192 of the Act. In this

case the company must go into liquidation, when the liquidator will sell the business to a new company, usually formed for the purpose, which may or may not take over all the assets and liabilities of the vendor company in consideration of the issue to the nominees of the liquidator of such company of partly paid shares in the new company, where the object is to raise more capital by an assessment on the shareholders of the old company, or where the object of the reconstruction is merely to reduce the capital without going to the Court in accordance with the procedure prescribed under Sec. 46 of the Act, the consideration would be the issue of a reduced number of fully paid shares in the new company. The shares issued by the new company will be allotted to the shareholders of the old company who elect to come under the scheme.

The term "reconstruction" should only be applied to cases which are dealt with under Sec. 192, and should not be confused with reorganization of capital under any other section of the Act. It is regretted that even eminent accountants and lawyers do not preserve this distinction, as undoubtedly in the mind of the general public reconstruction implies a reconstitution of the company itself, whereas reorganization merely signifies some alteration either in the rights attaching to certain classes of shares or in the nature of the company's capital, and does not imply liquidation.

A reconstruction may also be carried out under this section without involving a reduction of the capital, for any of the following purposes—

(1) Reorganizing share capital without proceeding under Sec. 45.

(2) Altering objects clause of the Memorandum.

(3) Altering domicile of company.

Where there is power in the Memorandum of the

company to make such a sale procedure under Sec. 192 of the Act is unnecessary, for the reconstruction will be carried out as provided in the Memorandum. The rights of dissentient shareholders under that section cannot, however, in any way be disturbed or taken away by the regulations of the company.

Shareholders who do not desire to come under any scheme of reconstruction under Sec. 192 of the Act are provided for, as the following rights have been given to them by that section, under which they may call upon the liquidator either—

- (1) To give up the scheme; or
- (2) To buy their shares at an agreed price, or, in the absence of agreement, at a price to be fixed by arbitration.

The shareholder must give the liquidator the option to do either of these things, and must express his dissent from the scheme in writing addressed to the liquidator, and left at the registered office of the company within seven days of the confirmation of the resolution.

The procedure under Sec. 192 requires a special resolution of the company, but the passing of the resolution does not bind dissentients provided they have not voted in favour of the resolution at either meeting. A shareholder who votes in favour of the resolution forfeits his right to dissent.

An executor of a deceased member may give notice of dissension even though he has not, himself, been registered as a member.

The arbitration under this section, where the company's Articles do not otherwise provide for arbitration, is to be carried out under the Companies Clauses Consolidation Act, 1845, or in the case of a winding-up in Scotland then under the Companies Clauses Consolidation (Scotland) Act, 1845. The Arbitration Act,

1889, also applies in so far as the provisions of foregoing Acts are not inconsistent therewith.

The Companies Clauses Consolidation Act, 1845, provides for the appointment of a single arbitrator agreed on by the parties or arbitrators appointed by each party, by writing under his hand, but if either party neglect or refuse to make the appointment for fourteen days after the dispute as to the price of the shares has arisen, the party giving notice may direct his own arbitrator to act after written notice requiring the appointment has been given to the other party. In the case of an arbitrator dying or refusing to act, the time is seven days for giving written notice. Where there are two arbitrators an umpire must also be appointed before entering upon the reference. If the arbitrators neglect to make the appointment of an umpire the Board of Trade may appoint one. The costs are in the discretion of the arbitrator.

The arbitrators would have to decide what the undertaking would fetch on a cash sale as a "going concern," and the proportion of that cash that the dissentient shareholder would be entitled to. Attempts are sometimes made to force a valuation of the assets at break up value upon dissentients. Such attempts should be resisted, as the shareholder is entitled to have the assets valued as being those of a going concern, but regard must be paid to the liabilities of the company. The paid-up value of the shares issued by the new company will be a good indication of the value of the net assets especially where the board of the new company is similarly constituted to that of the old company.

Where an objecting shareholder fails to give notice of his dissension in the stipulated time or manner he is not obliged in consequence to accept the liability on the new shares. He may decide that his better

course is to lose the money already parted with rather than send more good money after what is in many cases bad. He may, therefore, either assent to the scheme or dissent in manner prescribed in Sec. 192 or lose all interest in his shares.

### Association Clause.

The Memorandum must be signed by at least seven persons in the case of a public company, and the signatures must be attested.

The full name and description of each signatory must be set out together with the number of shares for which he has subscribed, which must be at least one.

The duties of the signatories are—

(1) To pay for the shares they have taken or agreed to take. The exception to this is where the whole of the share capital, including the signatory shares, has been allotted to others.

It is quite possible, however, for the signatories to hold their signatory shares as mere nominees for another, who may be allotted the whole of the remaining shares in the company.

The amounts due on the signatory shares are not payable until called up.

(2) To act as directors of the company until others are appointed.

(3) To sign the Articles of Association.

(4) To appoint the first directors of the company.

Where signatories are induced by the misrepresentation of the promoter to take shares in the company by signing the Memorandum, *Lord Lurgan's case* (1902) decided that they have no right of rescission against the company, as it did not exist at the time of the misrepresentation. There may, however, be a right of action against the promoter.

## THE ARTICLES OF ASSOCIATION

**The Nature of the Articles.**

The Articles of Association are the rules which govern the internal regulations of the company.

It has already been pointed out that the Memorandum cannot give the company power to do anything contrary to the provisions of the Companies Acts, 1908 to 1917. The Articles are not only limited by these Acts, but are also subsidiary to the Memorandum and cannot exceed the powers contained in the Memorandum. It was, however, decided in the case of the *London Financial Association v. Kelk*, 1883, that for the purposes of construction on points which need not necessarily be put in the Memorandum, they are to be read together, and the Articles may then explain any ambiguity in the Memorandum.

The Articles form an agreement between the company and the members as a body, regulating their rights between themselves, but they do not form a contract between the company and any individual member except in so far as they relate to his position as a member. Still less do they form a contract with the members of the outside world, e.g. where the Articles of a company provided for the life employment of a person as solicitor to the company, who became a shareholder whilst so employed, it was held that no action lay for breach of contract on the company ceasing to employ him as solicitor. (*Eley v. Positive Assurance Co., Ltd.*, 1876.) Such a provision in the Articles may, however, be evidence of a contract.

Sec. 14 of the Act provides that the Articles bind the company and the members to the same extent as if they had been signed and sealed by each member, and contained covenants by each member to observe them. The Articles therefore bind each member to



the company and to the other members, but it must be noted that the company is only bound as if the members had signed. It will be obvious that the signature of the members cannot bind the company, but nevertheless the company may be liable on a contract implied from the terms of the Articles as is the case where directors' fees are fixed by the Articles.

The rule in *Foss v. Harbottle*, 1892, is important in this respect. In this case the Court decided that where there is a breach of the company's regulations, neither a single member nor a body of members can sue in respect of the breach, since this is a matter which can be regulated by the company itself by a special resolution. If, however, the breach amounts to the doing of an act which is illegal, or beyond the powers of the company, or amounts to a fraud by the majority on the minority, any member may apply for an injunction restraining the company or the directors from giving effect to such breach of regulations.

### Table "A."

A public company need not have Articles, in which case the provisions of Table "A," the model set of Articles printed in the first schedule to the Companies (Consolidation) Act, 1908, will apply *in extenso*, and the Memorandum in such a case will be endorsed for registration "registered without Articles of Association." A private company must necessarily have its own Articles in order to comply with the provisions of Sec. 121 of the Act, as amended by the Companies Act, 1913, which are detailed on page 1.

The provisions of Table "A" will also apply to a company which does register its own Articles in so far as they are not expressly excluded or modified by the Articles registered. It is therefore important,

where Table "A" is not required to function, to have a clause in the Articles expressly excluding its application.

Table "A" of the Act of 1908 is printed in full as an appendix to this book. It is, however, subject to revision from time to time by the Board of Trade.

### **Form and Contents of Articles.**

Sec. 12 of the Act provides that the Articles must—

- (a) Be printed.
- (b) Be divided into paragraphs numbered consecutively.
- (c) Be stamped as if they were contained in a deed.
- (d) Be signed by each subscriber to the Memorandum in the presence of at least one witness, who must attest the signatures.

The Articles usually commence with a recital of those things which the Companies Acts make compulsory or prohibit, e.g. as to prohibiting the purchase of its own shares; it will then deal with the following matters—

- The form of the capital and rights of different classes.
- Regulation as to calls.
- Forfeiture of shares.
- Increase, reduction, and reorganization of capital.
- Transfer of shares.
- Share certificates.
- Meetings and voting powers.
- Accounts and audit.
- Dividends.
- Reserves.

Directors' remuneration, share qualification, and powers, and any other matters governing the administration of the company.

The Articles must not contain—

(a) Anything illegal, e.g. authorizing the payment of a dividend out of capital; or

(b) Anything outside the scope of the company's Memorandum.

The Rules of the Stock Exchange as to the inclusion of certain articles as to transfers of shares, powers of directors, etc., which are to be complied with where a quotation of shares is desired on the Stock Exchange, are set out in Chapter XIII.

### Alteration of Articles.

Sec. 13 of the Act provides that the Articles can be altered or varied only by special resolution of the company, and a company cannot deprive itself of the right to alter its Articles by a clause to that effect therein contained.

The Articles may thus be freely altered by special resolution, but such alteration must not be illegal, or *ultra vires* the company or constitute a fraud on the minority, but any arrangement for the benefit of the company as a whole would be allowed even though it inflicts a hardship on individual shareholders. The Companies (Foreign Interests) Act, 1917, prevents a company altering a clause in its Articles limiting the interest of aliens in the capital, management, or control of the company without leave of the Board of Trade.

Any alterations in or additions to the Articles made in the manner prescribed by Sec. 13 of the Act are as valid as if originally contained in the Articles, and are subject in like manner to alteration by special resolution.

A printed copy of every special resolution by which the Articles are altered is required under Sec. 70 of the Act to be filed with the Registrar of Companies within fifteen days of its confirmation.

### Effect of Registration of Memorandum and Articles.

The effect of the registration of the Memorandum and Articles of Association of the company with the Registrar of Companies is to affix persons dealing with the company, whether members or not, with notice of their contents.

The rule in the *Royal British Bank v. Turquand*, 1856, is important in this respect. This rule provides that no person dealing with the company is bound to see that it carries out its own regulations. Therefore, so long as the company is authorized by the Memorandum or Articles in the matter, if the only defect is that the sanction necessary for exercising these powers has not been obtained in accordance with the Articles, any person dealing with the company without knowledge of such defect is in a perfectly good position. It is, however, essential that such party has no knowledge of the breach of the regulations at the time he enters into the contract with the company.

The effect of borrowing beyond the powers of the company has already been dealt with in the chapter on Loanable Capital.

## CHAPTER VIII

### DIRECTORS AND OFFICERS OF THE COMPANY

THE promoter usually influences the appointment of the directors and officers of the company. Especially is this so where they are appointed by the Articles of the company.

### DIRECTORS

#### **Appointment and Choice of Directors.**

A company need not have directors, but without such the administrative part of the business would have to be carried on by the shareholders in general meeting, which would prevent the proper organization of the affairs of the company. It is therefore usual for a number of persons, selected from the members of the company, to be appointed as managers under the title of directors, to manage the administrative affairs of the business.

It is a mistake to appoint a large number of directors, except in special cases, for large directorates are very rarely a benefit to the company. The ruling factor in the appointment of directors should be quality, not quantity.

Clause 70 of Table "A" provides that directors shall hold at least one share in the company, so that the directors of companies working under Table "A" must be members, but there is no provision to that effect in the Act itself; consequently, where Table "A" is barred by the company's Articles and no provision is made therein that directors shall be appointed from the members of the company, it is possible for a person to be appointed a director who has no interest in the concern whatsoever, beyond his director's fees. The Articles, however, usually

make provision that the directors shall be members of the company, and most Articles go further than this by fixing a substantial share qualification.

Under Sec. 285 of the Act the term "director" is deemed to include any person occupying the position of director by whatever name called.

The directors are usually appointed in one of the following ways—

- (1) By the Articles.
- (2) By the signatories to the Articles.
- (3) By the other directors to fill a vacancy.
- (4) By the shareholders in general meeting.

Where the directors are not appointed by the Articles the signatories to the Articles will act as directors until they make the appointment of the first directors, either in writing signed by all of them or by a majority of them at a meeting at which they are all present.

Where the directors are named in the Articles, Sec. 72 of the Act provides that the appointment will not be valid unless each of the proposed directors has by himself or by his agent duly authorized in writing—

- (1) Signed and filed with the Registrar of Companies a consent to act as director; and
- (2) Signed the Memorandum for his qualification shares (if any) or a contract in writing to take them from the company and pay for them.

This provision does not, however, apply to private companies.

It will be noted that the above is one of the cases in which the agent must be appointed in writing to render the agency valid.

The appointment of subsequent or additional directors, and the appointment of directors to fill a casual vacancy, must be made in the manner prescribed by the Articles of the company; this may be either by the company in general meeting or by the continuing

directors. If the directors fail to fill a vacancy on the board of directors, or there is no provision in the Articles, the company may make the appointment in general meeting.

It is usually provided in the Articles that where the directors appoint an additional director or directors to fill a vacancy, the person or persons so appointed shall retire at the next annual general meeting, and offer themselves for re-election.

Officially, therefore, where the Articles do not make the appointment, the appointment of the first directors is in the hands of the signatories. In practice, however, it will be found, in many cases, that the promoter rules such appointment absolutely; in consequence there are promoters whose object is to catch the small investor, who direct the appointment of Lord Guinea Pig as chairman, with others of similar standing as co-directors, as for some reason it is hard to understand, directors of this class seem to inspire confidence in the concern on the part of the small investor.

Gentlemen whose only title to a seat on the board of directors is the name they bear and the guineas they find for any necessary share qualification, are known as "Guinea Pigs" or "Board Meetings only" directors, and their duties usually resolve themselves into signing cheques and voting as they may be directed by the master mind, who is usually the promoter. The day does not appear to be far distant, however, when the investing public will realize that commercial training is the best guarantee for the successful management of a company. When this fact bears fruit the day of the ornamental director will have passed, and such advertisements as the following (which appeared recently in a leading daily paper) will disappear—

"Director (non-active) required for company which is being formed with substantial capital, the major portion of which

is already subscribed. Company is being formed by well-known gentlemen to exploit very valuable concession which should secure large profits. Investment £5,000. Substantial director's fees and share of profits."

A director is supposed to direct, guide, and govern the policy of the company ; it is therefore difficult to comprehend how he can carry out his duties and remain " non-active." Persons who accept positions such as these usually invite trouble.

The choice of directors cannot be too carefully made, as their responsibilities are heavy, and call for special qualifications, for while they are entitled to rely to a certain extent upon their advisers, such as the secretary, solicitors, and accountants to the company, they should, if they are to appreciate quickly and readily the various points that from time to time arise in the administration of the business of a company, possess at least an acquaintance with the following subjects—

Company Law.

Law of Contract.

Law of Agency.

Sale of Goods Act.

Negotiable Instruments and Banking and Currency.

Accountancy and Costing.

Factory Management.

Economics and Finance.

Psychology.

Last, but by no means least, they should possess a thorough knowledge of the powers and regulations of the company contained in the Memorandum and Articles of Association. One or more directors should also have a knowledge of the technical side of the business.

Ignorance of these subjects has led directors into many business pitfalls which a mere acquaintance with the fundamental principles involved would have



avoided. Such knowledge would also save much valuable time and expense, and render such questions as the following unnecessary—

(a) Why does the balance of the Profit and Loss Account appear on the assets side of the balance sheet? The answer to this was that it should not appear there, but unfortunately the company had made a loss exceeding the profit brought forward from the previous period, and in consequence it must remain on that side of the balance sheet.

(b) Why does the freehold land purchased by the company appear in the balance sheet under the heading of "Freehold Land and Buildings," and not under "Investments"?

(c) Where there was a debit balance in the Profit and Loss Account—why cannot we declare a dividend when we have sufficient cash to pay it?

(d) Why should we provide for depreciation when we have made a loss?

These are only a few samples of the questions one is asked by directors from time to time.

On the other hand, there are very many companies possessing keen directors, with commercial training, who make the business of the company their first interest, and are able to locate with ease and rapidity the weak parts in the machinery of the business, whether it be in the manufacturing, buying, selling, or administration. A company so fortunate as to possess such directors rarely requires the services of an undertaker to prepare it for burial by way of liquidation. It would also be well if all directors adopted a motto such as "Take care of the business, and the shares will take care of themselves," as many directors pay too much attention to the share market to the consequent neglect of the business.

It may be thought that the standard of efficiency set

up here is too high, but it must be remembered that these days of keen foreign competition call for expert administration of our industries, and that no matter how good the machinery of the engine may be, if the driver has not a working knowledge of the same he cannot make it function efficiently.

Companies which are fortunate enough to possess a keen executive often succeed in spite of the bad administration of the business by the directorate, but they must nevertheless be seriously handicapped by it. There cannot, however, be a bad executive where there is a keen administrative body in control.

It is true, as decided in the case of *Lagunas Nitrate Co. v. Lagunas Nitrate Syndicate*, 1899, that such a high standard is not legally required from directors, but nevertheless commercial enterprise and competition require a much higher standard than that set by law, for as a rule legal authorities necessarily look at the matter from a purely legal viewpoint without taking into consideration the requirements of commerce and the efficient management of the business.

### Position of Directors.

Lord Selbourne, in the case of the *Great Eastern Railway v. Turner*, 1872, said: "Directors are the mere trustees or agents of the company—trustees of the company's money and property, and agents in the transactions which they enter into on behalf of the company."

(1) AS TRUSTEES. Directors are trustees to this extent, that they must exercise their powers, as defined in the Articles of the company, for the benefit of the members generally, and not for the benefit of themselves or any particular member. That is to say, they must approve transfers, make calls, issue and allot shares, declare dividends, make investments in the interests

of the company as a whole and not in the interests of any particular individual or individuals.

Directors do not, however, have to account so strictly as do other trustees, e.g. a trustee under a marriage settlement, since they are not legal owners of the company's property, but apart from the usual provisions in the Articles as to the keeping of accounts, directors must account to the company for their dealings with the funds in their capacity as agents.

In the absence of fraud, directors may claim the benefits of the Statutes of Limitations extended to other trustees.

In the case of *Land Allotment Co.*, 1894, Lord Justice Lindley said: "Although directors are not, properly speaking, trustees, yet they have always been considered and treated as trustees of money which comes to their hands, or which is actually under their control, and ever since joint stock companies were invented have been held liable to make good moneys which they have misapplied, upon the same footing as if they were trustees."

This position of trustees does not, however, extend to the individual character of the directors as shareholders.

The funds of the company are impressed with the nature of a trust, as they can only be applied to specific purposes laid down by statute.

(2) AS AGENTS. The general law of agency governs to a large extent the relationship between the company and its directors.

(a) *Ratification of Directors' Acts.* Directors, being in the position of agents for the company, are not personally liable on contracts they enter into on behalf of the company, provided they do not exceed their authority. If they do exceed their authority they will be liable, as are other agents, on a breach of warranty of authority.

Where the directors have merely exceeded their own authority but have not exceeded the powers of the company, the shareholders can relieve them of their liability by ratifying their act by an alteration of the Articles by special resolution, or by passing the directors accounts at the Annual General Meeting. Where, however, the directors have not only exceeded their own powers but have exceeded the powers of the company they are in a much more difficult position, for then the act of the directors cannot be ratified by the company even if every shareholder approves.

It will be understood from the foregoing that directors' are special agents and not general agents, that is to say, they have no authority to act in all matters concerning the company, but only have such powers as are definitely given them by the company's Memorandum and Articles.

The directors must act as a board or body, although in practice individual directors do often act on their own responsibility in cases of urgency, their acts being afterwards adopted by the board.

A managing director is, however, usually given power by the Articles to act independently of the board in certain matters, but he must account to the directors for such actions.

(b) *Personal Liability on Contracts.* In order to avoid personal liability directors should take special care to ensure that all documents to be signed by them show clearly by the context that they are acting on behalf of the company, and they should sign contracts, cheques, bills of exchange, etc.—

“ For and on behalf of the Public Company, Ltd.,

.....  
Director.”

Directors who have merely signed their names with the description “ Director ” below such signature,

have been held personally liable on a bill of exchange. Also where they sign under the name of the company without the word "Limited" or its recognized abbreviation they have personal liability.

Bills of exchange and promissory notes must be dealt with in accordance with Sec. 77 of the Act, which provides—

77.—A bill of exchange or promissory note shall be deemed to have been made, accepted, or endorsed on behalf of a company if made, accepted, or endorsed in the name of, or by or on behalf of, or on account of, the company, by any person acting under its authority.

Directors, like other agents or trustees, are entitled to be indemnified by the company against all losses and expenses properly sustained and incurred by them in the due performance of their office.

Whilst the directors thus enjoy the protection afforded to all agents, they also have the same liability as other agents for negligence or improper performance of their duty.

Directors are not liable for mere errors of judgment, but they are bound to use fair and reasonable diligence in the discharge of their duties.

In the case of *Lagunas Nitrate Co. v. Lagunas Nitrate Syndicate*, 1899, it was laid down that "if the directors act within their powers, and with such care as is reasonably to be expected from them, having regard to their knowledge and experience, and if they act honestly for the benefit of the company which they represent, they discharge both their legal and equitable duty to the company, and will not be liable for mistakes or errors of judgment."

The liability of directors for negligence and breach of trust and in respect of penalties under the Act is dealt with later in this chapter.

(c) *Secret Profits.* Directors, being agents, must

not make any secret profit out of their relation to the company, e.g. they must not accept their qualification shares as a gift, nor take a secret commission, which latter act is, of course, also an offence under the Corrupt Practices Act, and amounts to a bribe. Where in consequence of the payment of a secret commission the company has paid a higher price for goods than it should have done it may, in addition to obtaining the commission from the directors, sue the payer of the commission for a refund of the excess payment.

A director can, however, contract, or be interested in a contract, with the company where the Articles of the company expressly permit him to do so, but he must fully disclose his interest to the board at the time the contract is entered into and must not, as a rule, exercise his vote as a director in the matter, but he may use his vote as a shareholder at a general meeting at which the contract may be voted upon.

The foregoing rule does not prevent a director from entering into an agreement to take shares or debentures in the company.

Directors are also required by Sec. 81 of the Act to make a full disclosure of their interests in the company in any prospectus that may be issued to the public.

The object in placing such restrictions upon agents contracting with their principals is to avoid a conflict of interest between their private interests and their duty as agents, which, in the case of directors, might otherwise place the company in jeopardy.

(d) *Delegation of Authority.* The rule of agency, *delegatus non potest delegare*, by which an agent cannot delegate his authority, applies equally to directors, who cannot appoint any other person to act for them in any way, unless the Articles give them power to do so,

and consequently a director has in himself no power apart from the board unless the Articles otherwise provide.

The Articles usually provide that the directors may appoint one or more of their number to act as managing director or directors, but the persons appointed would not, as a rule, be allowed to vote on the appointment. Where such an appointment is made the directors may delegate some of their duties to such managing directors, but they must exercise proper supervision over the discharge of those duties.

The directors may also appoint committees from amongst their number to deal with certain matters, such as the passing of transfers, but such committees will have to report their decisions to the full board for approval.

### **Office of Profit.**

Directors cannot hold any office of profit in the company, such as secretary, solicitor, managing or technical director, etc., unless the Articles give power for them to be appointed to such an office, and the Act absolutely prohibits any director from holding the office of auditor to the company. It will be obvious that this prohibition is reasonable, for were it possible for a director to be appointed auditor there would be little protection afforded to shareholders, as he would then be auditor of his own accounts.

### **Remuneration of Directors.**

(a) RIGHT TO REMUNERATION. Directors are not entitled to any remuneration unless the Articles provide for it or, in the absence of such provision, it is voted to them by the company in general meeting, in which case they would have the right to sue for the agreed

sum or prove as ordinary creditors in the winding-up of the company.

The Articles usually provide for the remuneration of directors, in which case, unless the Articles also make provision for the alteration of such remuneration by the company in general meeting, it cannot be altered except by special resolution of the company altering the Articles.

The remuneration agreed upon will cover all travelling expenses and expenses of attending board meetings, unless the Articles make provision for an additional payment to be made to the directors in respect of such expenses.

A director who acts without acquiring his qualification shares (if any) may nevertheless be entitled to his remuneration up to the time the office becomes vacant.

Neither a director nor a managing director is a clerk or servant within the meaning of Sec. 209 of the Act, and consequently in a winding-up of the company directors are not entitled to rank preferentially in respect of the whole or any part of their remuneration, but merely rank as ordinary creditors.

(b) APPORTIONMENT OF REMUNERATION. The remuneration of directors will be apportionable only where it is fixed "at the rate of so much per annum," but not otherwise. That is to say, in this case, a director who acts for part of a year would be entitled to a proportionate part of his annual remuneration, apportioned from the commencement of the year up to the time he ceases to be a director, but if the remuneration is fixed as "a yearly sum of so much," or "so much per annum," he will receive no remuneration unless he acts for the full year.

(c) ADDITIONAL REMUNERATION. Additional remuneration may be given to directors for any special



services, where the Articles so provide. This may be voted, if so provided, by the company in general meeting or the directors may have power to vote extra remuneration to any of their number.

Where the power to fix extra remuneration is given to the board, the directors must exercise the power for the benefit of the company, and not merely for the benefit of any one or more of their number, or they may find themselves liable for gross negligence, as in the case of *Merchants' Fire Office v. Armstrong*, 1901, where the directors voted £15,000 to one of their number for "services," whereas he had only rendered the ordinary services of a director.

(d) WAIVER OF REMUNERATION. The remuneration of directors is payable whether profits are earned or not unless the Articles of the company provide to the contrary, but where the company has had a bad period of trading, directors sometimes agree among themselves to waive their right to remuneration for such period. In order to render the waiver effective all the directors must be present and vote on the resolution, for it is a contract between them all, the consideration for the waiving of the rights of one director being the waiving of the rights of all the others, without which it is not binding. The resolution of waiver must be carefully recorded in the minute book.

(e) TAXATION OF REMUNERATION. In the absence of a provision in the Articles to the contrary, or, where the remuneration is voted in general meeting, then in the resolution voting the same, directors are not entitled to have their fees paid free of income tax.

The payment of directors' fees free of income tax leads to a lot of unnecessary labour, for tax is not only payable on the remuneration itself but also on the tax paid. For example, take a simple case of the payment

of a director's fee of £50 per annum free of tax; the tax would be arrived at thus—

	£	s.	d.
Tax at 4s. 6d in £ on remuneration of £50 . . . . .	11	5	—
Tax upon tax of £11 5s. 0d . . . . .	2	10	8
Tax upon tax of £2 10s. 8d. . . . .	11	5	
Tax upon tax of 11s. 5d. . . . .	2	7	
Tax upon tax of 2s. 7d. . . . .		7	
Tax upon tax of 7d. . . . .		1	
Total tax paid by company	£14	10	4

In addition to this, strictly speaking, the benefits and allowances received by the director, such as the rate relief on the first £225 of his income, children's allowance, etc., should be apportioned between the income derived from his director's fees and his other income, otherwise the company will pay more than the actual tax on the fees. This further complication is, however, usually ignored in practice. Where the fees are also payable by the company "free of super-tax" the matter becomes further involved. The easiest way of getting over these difficulties is by voting a specific sum in lieu of the taxation on the fees or by making the fees "free of tax" at fixed rates, or better still by fixing the remuneration high enough to cover taxation leaving the directors to be taxed personally.

The directors' remuneration is taxable under Schedule E, and is earned income for the purposes of the directors' own private returns. The one-tenth allowance on earned income can consequently be claimed by them in respect of their fees, subject to a maximum allowance of £200 in respect of the whole of their earned income.

Where the remuneration is fixed as a percentage on profits it was decided in the case of *Johnston v. Chester-gate Hat Manufacturing Co., Ltd.*, 1915, that, in the absence of agreement to the contrary the percentage

must be calculated upon the profits before deduction of income tax.

### **Qualification Shares.**

There need not be any share qualification for directors, but the extent of their holdings in the company is an indication of their faith in the concern, and the promoter, in order to inspire confidence on the part of the investing public, usually arranges for a substantial share qualification to be fixed in the Articles.

The fixing of a large share qualification is not always in the best interests of the company, as such a procedure has a tendency to attract money rather than brains to the board of directors. It is, however, advisable that the directors should have some stake in the company, no matter how small, as it tends to make them more careful in the management thereof. Be that as it may, most companies do fix such a qualification for directors, although there is nothing in the Act to compel them to do so, and Table "A" is also silent on the matter.

Sec. 73 of the Act provides, however, that where the regulations of the company require directors to hold a specified number of qualification shares, such shares must be obtained within two months of appointment or such shorter time as may be fixed by the regulations of the company. If the shares are not obtained within the two months, or shorter time specified, the office becomes vacant and the person acting as director renders himself liable to a fine of £5 a day for every day he continues to act as director.

In order to prevent chaos arising from an invalid appointment, Sec. 74 of the Act provides that the acts of a director will be valid, notwithstanding any defect that may afterwards be discovered in his appointment or qualification.

It has already been mentioned that a director, being an agent, must not make a secret profit. He cannot, therefore, take his qualification shares as a gift from the promoter, or any other person unless this fact be known to and approved by the company. Otherwise the company, on discovering the gift, may claim from him either the face value of the shares or, if they have been at a premium, then the highest value they have reached during the time the director has held them.

In the case of *re London and South-western Canal Co., Ltd.*, 1911, it was held to be a misfeasance on the part of a director who takes his qualification shares from the promoter and executes a blank transfer in his favour as this enables the promoter to disqualify him at will.

The first directors must take their qualification shares from the company direct, but subsequent directors are not bound to do so, but may acquire them by transfer, transmission, or in any other manner, except that if they receive them as a gift they must disclose the fact to the company and obtain its approval.

Any person appointed as director and who has actually acted in that capacity will be deemed to have contracted to take his qualification shares and his name may be placed on the Register of Members in respect thereof, and in the event of subsequent winding-up he would be liable to be placed on the List of Contributories. Where, however, a director has been appointed but resigns, without having acted as director, within the stipulated time of two months or shorter time provided by the Articles, he has no liability to pay for the qualification shares.

The Articles sometimes provide that a person shall not be eligible for appointment as a director unless he possesses the necessary qualification shares, and in such

a case he must hold the shares at the time of his election or his appointment will be invalid.

Where it is provided that the director must hold his qualification shares in his own right, it is sufficient if he holds them as a trustee, but not if he holds them as liquidator of a company. That is to say, that while he is not obliged to hold the shares as beneficial owner, he must be in such a position as holder of the shares that the company may deal with him as legal owner.

Where the Articles provide that the director must be the registered holder of a certain number of shares it has been decided by the case of *Grundy v. Briggs*, 1910, that the joint holding of shares would be a sufficient qualification. It is submitted, however, that only one of the joint holders would be allowed to act in respect of the same shares.

Sec. 37 (4) provides that shares or stock represented by share warrants shall not be capable of forming part of any share qualification required by the Articles.

Sec. 81 of the Act requires the share qualification to be stated in any prospectus issued within one year of the company being entitled to commence business, and Sec. 87 provides, *inter alia*, that the company cannot commence business until every director has taken up his qualification shares, within the specified time, and paid on them, if payable in cash, the same proportion as the public have to pay on application and allotment. These provisions of Secs. 81 and 87 do not apply to private companies.

The qualification clause may be made to apply to some directors, while not applying to others.

### **Disqualification, Removal, and Resignation of Directors.**

(a) **DISQUALIFICATION.** The Articles of the company will provide the circumstances under which a director

may be disqualified. Such provisions usually fall into line with clause 77 of Table "A," which provides that the office of a director shall be vacated if the director—

(1) Ceases to be a director under Sec. 73 of the Act ; that is, where he does not acquire his qualification shares within two months of appointment ; or

(2) Holds any other office of profit under the company except that of managing director or manager ; the Articles also sometimes except the office of secretary ; where no such exceptions are provided for in the Articles, and a director accepts such an office he automatically vacates his directorship ; or

(3) Becomes bankrupt ; this means, becomes bankrupt after election, consequently a person may be appointed director even though he be an undischarged bankrupt at the time of his election ; or

(4) Is found lunatic or of unsound mind ; or

(5) Is concerned or participates in the profits of any contract with the company ; provided, however, that no director shall vacate his office by reason of his being a member of any company which has entered into contracts with, or done any work for, the company of which he is a director ; but a director shall not vote in respect of any such contract or work, and if he does so vote his vote shall not be counted.

(6) In addition to the foregoing, the Articles usually contain a provision, not contained in Table "A," that the office of director shall become vacant if any director shall fail to attend, say, six consecutive meetings without leave of absence.

A director acting while disqualified is liable to a fine of £5 a day for every day that he so acts, and the company may recover from him any fees paid to him while so disqualified.

(b) REMOVAL AND RETIREMENT. A director can be removed by the shareholders during the term of his

office only where there is a special provision to that effect in the Articles. The Articles usually require a special resolution to be passed before a director can be removed. Clause 86 of Table "A" requires an extraordinary resolution for removal of a director, and an ordinary resolution for the appointment of another person in the place of the director so removed.

Where there is no power in the Articles for the shareholders to remove directors, the power must be taken by special resolution, and then exercised as required by the power itself before directors can be removed.

As a rule, Articles also provide that the directors, other than managing directors, shall retire in rotation. In some cases, however, the Articles provide for the retirement of a certain number of directors, in which case the board usually decides by lot, in the first years of the company, who those directors shall be, after which they will retire in rotation.

Retiring directors are, usually, eligible for re-election, and they will remain in office until successors are appointed, unless they are removed without the appointment of successors.

This retirement by rotation gives the shareholders an opportunity of reviewing the capabilities and suitability of the directors retiring, and for that reason, it is advisable to leave the proposal and seconding of the re-election of the retiring directors to the shareholders' side of the table.

(c) RESIGNATION. A director wishing to resign must abide by the provisions of the Articles as to resignation. The Articles usually allow a director to resign by giving notice in writing to the company. If the Articles are silent as to resignation, the directors, being agents, would have the ordinary right of an agent to determine

the agency, but in this case to be effective the resignation should be accepted by the company in general meeting or, alternately, they may render their office vacant by selling the whole or part of their qualification shares (if any).

It was decided in the case of *Glossop v. Glossop*, 1907, that a director who has resigned cannot be allowed to withdraw his resignation. He must be re-appointed by the company as the resignation is irrevocable.

### **Liability of Directors.**

(a) NEGLIGENCE, BREACH OF TRUST, AND FALSIFICATION OF ACCOUNTS. It has already been mentioned that directors may be personally liable on contracts, which they purport to make as agents for the company, where they do not enter into the contracts in the prescribed manner, or where they have no power to enter into them, in which latter case they would be liable on a breach of implied warranty of authority.

Directors, in addition to the foregoing, are also personally liable for torts, negligence, and breach of trust as follows—

(1) Under Sec. 84 of the Act, which replaced the Directors' Liability Act, 1890, to persons who subscribe for shares on the strength of untrue statements contained in a prospectus issued under their authority.

The plaintiff in an action brought under this section has to show—

(i) That there was a mis-statement of fact ;

(ii) That he was deceived ; and

(iii) That he suffered damage ; the measure of damage being the difference between the value of shares in a company having the advantages stated in the prospectus, and the value of shares in a company



without these advantages, the difference being ascertained on the day after allotment.

The directors sued will then be liable unless they can show that they not only believed the statements to be true, but that they had reasonable grounds for such belief.

(2) To repay dividends paid out of capital with interest at 5 per cent. The liability in this case is joint and several, and a director who has repaid such dividends may claim contribution from his co-directors. Shareholders who have knowledge of the fact that such dividends have been paid out of capital must, however, refund the same to the company, and the directors' liability would be reduced to that extent.

(3) For negligence or breach of trust. Want of due care and diligence is negligence, but an honest error in judgment is not, and it is necessary to take into account this difference before bringing an action against directors for negligence. The remedy for negligence or breach of trust is by action while the company is a going concern but, if liquidation has commenced, proceedings must be taken under Sec. 215 of the Act, which provides as follows—

215.—(1) Where in the course of winding-up a company it appears that any person who has taken part in the formation or promotion of the company, or any past director, manager, or liquidator, or any officer of the company, has misapplied or retained or become liable or accountable for any money or property of the company, or been guilty of any misfeasance or breach of trust in relation to the company, the Court may, on the application of the official receiver, or of the liquidator, or any creditor or contributory, examine into the conduct of the promoter, director, manager, liquidator, or officer, and compel him to repay or restore the money or property or any part thereof respectively with interest at such rate as the Court thinks just, or to contribute such sum to the assets of the company by way of compensation in respect of the misapplication, retainer, misfeasance, or breach of trust as the Court thinks just.

Misfeasance is a breach of duty not involving the misapplication of the company's funds, but resulting in a loss to the company.

Breach of trust is a misapplication of the company's funds, which are impressed with the nature of a trust.

It is a regrettable anomaly in company law that proceedings under Sec. 215 may be rendered ineffective by such a clause in the Articles as was contained in the Articles of the City Equitable Fire Insurance Co., Ltd.

In the case of *re City Equitable Fire Insurance Co., Ltd.*, 1924, a misfeasance summons was brought against the directors and others under Sec. 215. Clause 150 in the Articles of that company provided that the directors and officers should not be answerable for any loss which might happen in the execution of their respective offices or trusts or in relation thereto "unless the same shall happen by or through their own wilful neglect or default respectively." Mr. Justice Romer held that such an Article was a fatal objection to a misfeasance summons, under Sec. 215, against directors and officers for negligence, where the negligence was not wilful, and there was no dishonesty on their part.

In view of this decision it would be well for investors to examine the Articles of companies before purchasing shares therein; taking care to avoid investment in companies whose articles contain such a clause, as it leaves the directors free from all liability in the discharge of their duties, except that attaching to fraud or wilful negligence or involving a breach of statutory requirements, and encourages that lack of care on the part of directors which is so disastrous to the proper administration of the company's affairs.

The estate of a deceased director cannot be made

liable for negligence unless it has benefited thereby. Where, however, the claim is in the nature of a breach of trust, e.g. the payment of a dividend out of capital, the estate would be liable.

Directors who have not taken part in the breach of trust and have no notice of it, are not liable for the acts of their co-directors provided they were not in a position which would lead them to enquire into the matter and neglected to do so, in which case they would be liable. A director who has been rendered liable is, however, entitled to contribution from co-directors equally liable.

(4) For falsification of Accounts and Reports under Secs. 216 and 281 of the Act, and Secs. 82 and 84 of the Larceny Act, 1861.

(b) PENALTIES UNDER THE ACT. Directors are also liable to penalties imposed by the Act under the following sections—

(1) Sec. 25, of £5 a day, for not keeping a Register of Members.

(2) Sec. 26, of £5 a day for not filing an Annual List and Summary.

(3) Sec. 64, of £50 for not calling a general meeting in every calendar year within fifteen months of the preceding meeting.

(4) Sec. 70, of £2 a day for not sending to the Registrar of Companies copies of all Special and Extraordinary Resolutions.

(5) Sec. 75, of £5 a day for not keeping a Register of Directors and Managers, and notifying any changes in the constitution of the Board.

(6) Secs. 85 and 86, to compensate the company and allottees in case of an irregular allotment of shares.

(7) Sec. 88, of £50 a day for not filing the Return of Allotment.

(8) Sec. 92, of £5 a day for not having Share Certificates ready for delivery within two months of allotment or registration of a transfer.

(9) Sec. 100, a fine not exceeding £50 for failure to make proper entries in the Register of Mortgages and Charges.

(10) Sec. 101, a fine of £5 and a further fine of £2 a day for refusing inspection of Register of Mortgages and Charges and documents relating thereto.

(11) Sec. 102, a fine of £5 and further fine of £2 a day for refusing to allow inspection of Register of Debenture Holders, and forwarding copies of any Trust Deed to Debenture Holders requiring same.

(12) Sec. 113, £50 for issuing any balance sheet not properly signed or without the auditors' certificate attached to or referred to therein.

(c) RELIEF FROM LIABILITY. Sec. 279 of the Act provides relief from liability to directors in certain cases. This section is as follows—

279.—If in any proceeding against a director, or person occupying the position of director, of a company for negligence or breach of trust it appears to the Court hearing the case that the director or person is or may be liable in respect of the negligence or breach of trust, but has acted honestly and reasonably and ought fairly to be excused for the negligence or breach of trust, that Court may relieve him, either wholly or partly, from his liability on such terms as the Court may think proper.

### **Board Meetings.**

It has already been stated that, in the absence of a provision to the contrary in the Articles, directors cannot act individually, but must act together in a body known as the board of directors.

The board of directors must act in meetings, called board meetings, unless the Articles gives them power to act otherwise, e.g. by permitting resolutions signed by all the directors to be as effective as though passed

in meeting. The board meetings may be held anywhere, though it is usual to hold them at the registered office of the company. The meetings will, as a rule, be summoned, on the instructions of the chairman, by the secretary, who should send with the notice an agenda of the meeting setting out clearly the business to be transacted.

(a) NOTICE OF MEETINGS. Every director is entitled to due notice of the holding of board meetings. The notice required will be fixed by the Articles, which usually require at least three days' notice to be given.

(b) QUORUM. Before the business of the meeting can be proceeded with a quorum of directors must be present, otherwise the resolutions will have no effect. The quorum necessary will be determined by the Articles, which usually require at least two directors, or it may be left to be fixed by the directors themselves.

Clause 88 of Table "A" provides for the quorum being fixed by the directors themselves, or where it is not so fixed then, when the number of directors exceeds three, the quorum must be three.

(c) MINUTES. The decisions of the directors take the form of resolutions, e.g. "Resolved that Lord Guinea Pig be and he is hereby appointed chairman of the board of directors."

The resolutions are passed by a simple majority of the directors present at the meeting, but where there is an equality of votes the chairman may have a casting vote. The chairman is not, however, entitled to a casting vote unless the Articles of the company give him one.

Minutes of the meeting must be kept by the secretary, and are signed by the chairman, if approved, at the next succeeding meeting, the proceedings of which are usually opened by the secretary reading the minutes

of the preceding meeting. When so signed they are *primâ facie* evidence of the proceedings, but are not conclusive, and any unrecorded resolution may be proved on production of sufficient evidence.

Directors should be careful to see that they fully understand the purport of the various resolutions submitted before they allow them to be passed. This was emphasized in the case of *Everett v. Griffith*, 1924, which decided that where a resolution is recorded in the minutes as having been passed unanimously by a board, every member of the board present must, *primâ facie*, be taken to have voted for the resolution, even though the votes were not expressly recorded. In this case Mr. Justice McCardie said: "A man may give his vote in divers ways, either by writing or by hand, or by voice, or by conduct, e.g. by a nod. The form in which acquiescence is given matters not if acquiescence be actually indicated."

(d) ABSENCE FROM BOARD MEETINGS. Continued absence from board meetings may make a director liable for the acts of his co-directors, though he is not expected to be present at all meetings. Such absence may also render his office vacant.

A director will not, however, be liable for the acts of his co-directors at a meeting at which he was not present, unless such director is an habitual absentee.

(e) DISQUALIFIED DIRECTORS' ACTS VALID. The Articles generally contain a clause that if it shall afterwards be found that the directors were disqualified or improperly elected any acts done by them shall be valid, despite such disability, and Sec. 74 of the Act provides for this even though the Articles are silent on the matter.

(f) FIRST BOARD MEETING. The first board meeting will be called as soon as the solicitors have completed the work entailed in obtaining registration, preparing

purchase agreements, and drafting prospectus. The usual agenda for such meeting will be—

- (1) To appoint Chairman.
- (2) To inspect the Certificate of Incorporation.
- (3) To receive the report of the registration of the situation of the registered offices.
- (4) To fix a quorum for board meetings (unless this has already been fixed by the Articles).
- (5) To submit the seal of the company for approval and pass resolutions as to custody of keys and method of sealing documents, where this latter is not provided for in the Articles. It is usual to provide that the secretary shall affix the seal in the presence of two directors. The seal is often provided with two different locks, in which case the key of one would be kept by the secretary and the key of the other by the chairman.

An impress of the seal should be placed in the margin of the Minute Book, for identification, against the resolution approving it.

(6) To appoint bankers, solicitors, auditors, and brokers. The bankers on appointment will usually require—

- (i) Specimen signatures of the directors and secretary on a special form provided by the bank on application.
- (ii) Copy of the resolution appointing them.
- (iii) Copy of the Memorandum and Articles of Association of the company.
- (iv) To inspect the Certificate of Incorporation and, before the account can be drawn upon, to inspect the Trading Certificate when obtained.
- (v) Copy of resolution as to the method of drawing, accepting or endorsing cheques and bills of exchange.
- (7) To appoint secretary, or secretary *pro tem*, and fix his remuneration.

The professional accountant is often called upon to act as secretary *pro tem*, and registrar to the company, in order that the complicated accounting attending the formation of the company and the public issue of capital may be under his direct supervision.

(8) To submit purchase agreement, and if passed to affix the company's seal thereto and arrange for the business or businesses to be taken over.

(9) To submit final draft prospectus, form of application for shares, and form of underwriting letter for approval, and if approved to pass a resolution that the prospectus be dated and issued forthwith.

### **Publication of Directors' Names.**

Limited companies incorporated after the 22nd November, 1916, must comply with the provisions of the Registration of Business Names Act, 1916, and the Companies (Particulars as to Directors) Act, 1917, by disclosing in all trade catalogues, circulars, show cards, and business letters, also in the Annual Summary and Register of Directors—

- (a) The names of all the directors.
- (b) Any former names.
- (c) Nationality if not British.
- (d) Nationality of origin if not the same as the present nationality.

The term "Director" for this purpose includes any person who occupies the position of a director, by whatever name called, and under whose directions or instructions the directors are accustomed to act.

The penalty of non-compliance with this provision incurred by the company and every director, secretary, and officer of the company who is knowingly a party to the default is a fine, on summary conviction, not exceeding £5 for every day during which default continues.



### Checks on Directors.

The following may be said to be the most important checks placed by the Act on the actions of directors—

(1) The statutory meeting, at which all matters relating to the promotion of the company may be discussed.

(2) The audit and auditor's report required under Sec. 113 of the Act, if the auditors are duly qualified accountants.

(3) The annual general meeting, when the dealings of the directors with the funds and property of the company can be challenged.

(4) The right of shareholders—

(a) to requisition an extraordinary general meeting under Sec. 66 of the Act.

(b) to obtain an investigation into the affairs of the company by the Board of Trade under Sec. 109 of the Act.

(c) to appoint inspectors to make an investigation under Sec. 110 of the Act.

(5) The file at Somerset House, which is at the service of the public.

(6) The possibility of liquidation and consequent investigation by the liquidator or the Official Receiver.

### OFFICERS OF THE COMPANY

#### Secretary.

The secretary is the principal officer of the company. It is through him that the directors usually give their orders, and he is directly responsible to the board for seeing that such orders are properly and expeditiously carried out. In fact he is the servant of the board, and is appointed and has his remuneration fixed by the directors. He is not, or should not be, however, the servant of any individual director.

The duties of the secretary may be summarized as follows—

(a) To obey the instructions of the board, except when such instructions are contrary to law or the provisions of the Memorandum and Articles of the company.

(b) To see that all proceedings at and notices of meetings, whether of the board or of shareholders, are carried out or despatched in a regular manner.

(c) To see that the requirements of the Companies Acts and the Memorandum and Articles of Association are complied with.

(d) To countersign cheques and dividend warrants, and authenticate the sealing of documents including share certificates.

(e) To see that the statutory books are properly kept, and ensure that all transfers are in order before being passed by the board.

(f) To attend to the filing of documents at Somerset House required by the Act to be filed.

(g) To prepare the directors' accounts where no accountant is appointed by the company.

In many of the above duties the secretary is assisted by a person appointed as registrar to the company.

It will be seen from the scope of the secretary's duties that he is expected to be well versed in company law and accountancy. He must always exercise his duties impartially, and should be possessed of great tact, as his influence at board meetings, when brought into play at the right moment, often averts what might otherwise be, to say the least, unpleasant incidents.

### Auditors.

(a) IN RELATION TO THE COMPANY AND SHAREHOLDERS. An auditor appears to be an officer of the company in so far as his duties as auditor are concerned.

Sec. 112 of the Act refers to the office of auditor, and it was decided that he was an officer of the company in the cases of the *London and General Bank*, 1895, and the *Kingston Cotton Mill Co., Ltd.*, 1896. On the other hand, Sec. 112 provides that a director or officer of the company shall not be capable of being appointed auditor to the company. It is therefore doubtful whether an auditor may be considered to be an officer of the company for all purposes. He is certainly not an officer of the company, however, in respect of work done for the directors in his capacity of accountant.

The auditor is the agent of the shareholders in so far as his duties as auditor are concerned, and he must make his report to them, but it has been held that notice given to him in his capacity of auditor is not notice to the shareholders so as to bind them, as is ordinarily the case between principal and agent.

(b) APPOINTMENT AND REMUNERATION. The appointment and remuneration of auditors is governed by Sec. 112 of the Act, which is as follows—

112.—(1) Every company shall at each annual general meeting appoint an auditor or auditors to hold office until the next annual general meeting.

(2) If an appointment of auditors is not made at an annual general meeting the Board of Trade may, on the application of any member of the company, appoint an auditor of the company for the current year, and fix the remuneration to be paid to him by the company for his services.

(3) A director or officer of the company shall not be capable of being appointed auditor of the company.

(4) A person, other than a retiring auditor, shall not be capable of being appointed auditor at an annual general meeting unless notice of an intention to nominate that person to the office of auditor has been given by a shareholder to the company not less than fourteen days before the annual general meeting, and the company shall send a copy of any such notice to the retiring auditor, and shall give notice thereof to the shareholders, either by advertisement or in any other mode allowed by the Articles, not less than seven days before the annual general meeting.

Provided that if, after notice of the intention to nominate an auditor has been so given, an annual general meeting is called for a date fourteen days or less after the notice has been given, the notice, though not given within the time required by this provision, shall be deemed to have been properly given for the purposes thereof, and the notice to be sent or given by the company may, instead of being sent or given within the time required by this provision, be sent or given at the same time as the notice of the annual general meeting.

(5) The first auditors of the company may be appointed by the directors before the statutory meeting, and if so appointed shall hold office until the first annual general meeting, unless previously removed by a resolution of the shareholders in general meeting, in which case the shareholders at that meeting may appoint auditors.

(6) The directors may fill any casual vacancy in the office of auditor, but while any such vacancy continues the surviving or continuing auditor or auditors, if any, may act.

(7) The remuneration of the auditors of the company shall be fixed by the company in general meeting, except that the remuneration of any auditors appointed before the statutory meeting, or to fill any casual vacancy, may be fixed by the directors.

It will be seen that although the appointment and remuneration of the auditors may be fixed by the Board of Trade or directors in certain cases, yet these matters are ultimately in the shareholders' hands entirely.

The difficulty in removing an auditor when once appointed will also be apparent. This provision is all to the good, for it greatly strengthens the hand of the auditor when dealing with the directors. The object of the provision with regard to the re-election of a retiring auditor is to prevent unscrupulous directors forcing their wishes upon an unwilling auditor, to the detriment of the interests of the shareholders, under penalty of not being re-elected.

The only other legitimate method of removing an auditor who refuses to resign than that provided for in Sec. 112 is by reconstructing the company. The

reduction of the audit fee is not a legitimate way of removing the auditor.

(c) RIGHTS AND DUTIES. The rights and duties of the auditors are defined by Sec. 113 of the Act, and in the multitude of cases decided in the Courts on the subject.

Sec. 113 gives the auditor a right of access at all times to the books, accounts, and vouchers of the company, and entitles him to require from the directors and officers of the company such information or explanations as may be necessary for the performance of his duty as auditor.

It was decided in the case of *Newton v. Birmingham Small Arms Co., Ltd.*, 1906, that it is beyond the powers of the company to interfere with the rights of the auditors under Secs. 112 and 113 of the Act. Any clause in the Memorandum or Articles purporting to do this is invalid and totally ineffective.

The duty of the auditor is to make a report to the shareholders on the accounts examined by him, and on every balance sheet laid before the company in general meeting.

The report made by the auditors must state—

(1) Whether or not they have obtained all the information and explanations they have required; and

(2) Whether, in their opinion, - the balance sheet referred to in the report is properly drawn up so as to exhibit a true and correct view of the state of the company's affairs according to the best of their information and the explanations given them and as shown by the books of the company.

It is an anomaly that although provisions are made in the Act for the audit and signature by directors of a balance sheet, the preparation of the same is not compulsory under the Act. Clause 107 of Table "A," however, makes provision for a balance sheet to be

prepared by companies working under that Table, and it is uncommon to find no provision contained in the Articles of the company for the preparation and submission of the balance sheet to shareholders in general meeting. The Articles, as a rule, go further, and also provide for the submission to shareholders of a Profit and Loss Account. In this case, however, the information is necessarily so condensed that it is of little value to shareholders. The object of such condensation is to avoid giving information which might be useful to competitors.

Every balance sheet must be signed by at least two directors, or where there is only one director, by that one, except in the case of a banking company where there are more than three directors, in which case it must be signed by three directors and, in addition, by the secretary or manager (if any). The directors who sign the balance sheet sign on behalf of the whole board of directors, and do not, by so signing the balance sheet, relieve their co-directors of joint responsibility for statements therein contained.

A copy of the auditor's report must be attached to every balance sheet issued, or a reference to it made therein.

Failure to comply with these provisions renders every director, manager, secretary, or officer of the company, who is knowingly a party to the default, liable to a fine not exceeding fifty pounds.

The power thus given to auditors of companies acts as a great deterrent to directors, who may have a tendency to stray a little from the path of rectitude for, as already stated, the regulations of the company cannot interfere with the auditor's statutory duty to report the true position of the affairs of the company to the shareholders, and the auditor should do so in language which clearly indicates the position so

that the average shareholder may understand the same.

The amount of work to be done by the auditor in ascertaining the true position is largely at his own discretion. It would, obviously, be impossible for him to check every item in detail in large companies, and the science of accountancy has reached such a high standard of efficiency that this is rendered unnecessary in most cases. It was decided in the case of the *London General Bank*, 1895, that where there was nothing to excite suspicion, and the auditor took a few cases at random and found them correct, it was reasonable for him to assume that items of a like nature were also correct.

The auditor must, however, bring to bear on his work that skill, care, and caution which a reasonably competent, careful, and cautious auditor would use, but he is not bound to be a detective, or to approach his work with a foregone conclusion that something is wrong. He is justified in believing tried and trusted servants of the company, in whom the company itself places confidence. He must, however, use reasonable care although he is a watchdog, not a bloodhound. It has further been decided that an auditor is not a valuer, and also that it is no part of his duty to give advice to directors. (*Kingston Cotton Mill Co.*, 1896.)

Auditors must not only make themselves acquainted with their statutory duties, but they must take cognizance of any special duties laid upon them by the Articles of the company.

The standard set up for their members by the Institute of Chartered Accountants and the Society of Incorporated Accountants and Auditors, who style themselves respectively Chartered Accountants and Incorporated Accountants, has been adopted by the

Courts in recent years as an indication of the standard of the qualifications a person holding himself out as an auditor is expected to possess.

In addition to his duty in respect to the audit of the balance sheet the auditor of a public company is also required—

(1) By Sec. 65 of the Act to certify so much of the Statutory Report as relates to :

- (i) The shares allotted by the company ;
- (ii) The cash received in respect of such shares ;
- and
- (iii) The receipts and payments of the company on capital account.

This certificate is only required where the auditor has been appointed before the statutory meeting.

(2) To audit the statement in the form of a balance sheet required to be filed annually at Somerset House under Sec. 26 of the Act.

The auditor has no right to attend either board meetings or general meetings of the company unless he is also a shareholder, when he may attend the latter in that capacity. He is, however, usually requested to be present at general meetings, but it is much to be regretted that his presence is not more often required at board meetings, at which the accounts of the company come up for consideration, as he is usually in a position to be of great assistance to directors in advising them as to the proper interpretation to put upon the story told by the accounts.

(d) LIABILITY OF AUDITORS. Auditors are liable for negligence in the performance of their duties, and may be sued in respect thereof while the company is a going concern, but proceedings must be brought under Sec. 215 of the Act if the company is in liquidation.

Auditors are also criminally liable under Sec. 281



of the Act for wilfully making false statements in any report or balance sheet.

**Persons who are not Officers of the Company.**

The bankers, solicitors, and brokers are not officers of the company whilst acting in their respective capacities.

## CHAPTER IX

### THE BOOKS AND ACCOUNTS OF THE COMPANY

THE secretary must at this stage obtain the books of the company, which may be classified into secretarial and financial books.

#### **Secretarial Books.**

The principal books required, in addition to the ordinary books of account, are—

- (a) THE COMPULSORY BOOKS. (1) Register of Members, with which is usually combined the Share Ledger.
- (2) Register of Directors and Managers.
- (3) Register of Mortgages and Charges.
- (4) Directors' Minute Book.
- (5) Shareholders' Minute Book.
- (6) Annual List and Summary Book.

The above books are termed the statutory books of the company because the Act makes it compulsory for every company to keep them.

(b) THE OPTIONAL BOOKS. The following books are optional in the sense that the Act does not require them to be kept, but in practice it would be found most difficult to keep the secretarial records without the use of most of them.

- (7) Register of Transfers.
- (8) Seal Book.
- (9) Directors' Attendance Book.
- (10) Application, Allotment, and Call Sheets or Book.
- (11) Shareholders' Cash Book.
- (12) Share Certificate Book.
- (13) Notice of Transfers Lodged Book.

- (14) Transfer Receipt Book.
- (15) Balance Receipt Book.
- (16) Transfer Fees Book.

### Register of Members and Share Ledger.

(a) CONTENTS OF REGISTER. A Register of Members must be kept in accordance with Sec. 25 of the Act, in which must be entered—

(1) The names, addresses, and occupations of the members.

(2) The number of shares held by each member, distinguishing each share by its distinctive number.

(3) The amount paid or agreed to be considered as paid on the shares of each member.

(4) The date at which each person was entered on the register as a member.

(5) The date at which he ceases to be a member.

Sec. 33 of the Act provides that entries in the register are not conclusive, but only *prima facie* evidence of any matters by the Companies Act directed or authorized to be inserted therein.

The Register of Members may be contained in one or more books. This is a reasonable provision, as it would obviously be impossible for large companies, where there is an active market in the shares, to keep the particulars required in one book, not only by the size such a book might reach, but also by the disorganization in the transfer office such a procedure would cause.

Failure to make the required entries in the register renders the company, and every director and manager of the company who knowingly or wilfully authorizes or permits the default, liable to a penalty of £5 for every day during which the default continues.

(b) ENTRIES IN REGISTER ON CONVERSION OF SHARES INTO STOCK OR CREATION OF SHARE WARRANTS. Where

shares are converted into stock, Sec. 43 of the Act requires the change to be recorded in the Register of Members by showing the amount of stock held by each member instead of the particulars relating to shares required by Sec. 25.

In the case of an exchange of share certificates for share warrants to bearer, the name of the shareholder is struck out of the Share Register, and particulars of the shares or stock comprised in and the date of the issue of the warrants are entered therein. Details of the warrants will then be recorded in a share warrant register. The method of dealing with share warrants is fully described on page 257.

(c) COLONIAL REGISTER OF MEMBERS. A company having colonial branches would find it a difficult matter to secure capital or obtain a market for its shares in those countries if shareholders with colonial residence were restricted, in dealing with their holdings, by the lapse of time that would take place before a transferee could be registered as the holder in the Register of Members kept in this country. This difficulty has been legislated for in Secs. 34 to 36 of the Act, under the provisions of which a company having colonial branches is permitted to keep a Colonial Register of Members in respect of the members resident in such colonies subject to the following conditions—

(1) Notice of the situation of any office in which the Colonial Register is kept, or of any change in or discontinuance of that office must be given to the Registrar of Companies.

(2) A duplicate of the Colonial Register must be kept at the registered office of the company.

(3) Copies of entries in the original Colonial Register must be sent to the registered office for entry in the duplicate Colonial Register as soon as may be after they are made.

(4) The Colonial Register is deemed to be part of the company's Register of Members.

(5) A transfer of shares registered in a Colonial Register is deemed to be a transfer of property out of the United Kingdom, and is exempt from British stamp duty unless it is executed in any part of the United Kingdom.

(6) On the death of a member registered in the Colonial Register where such member dies domiciled in the United Kingdom, but not otherwise, British estate duty is payable on the shares passing on his death.

Any colonial death duty payable in respect of such shares can, however, be deducted from the duty payable in the United Kingdom under the Finance Act, 1894.

(d) FORM OF REGISTER OF MEMBERS. It is usually found to be more convenient to combine the Register of Members with the Share Ledger. As will be seen later the Register of Members will be written up from the following—

(1) Application and Allotment Sheets or Book.

(2) Call Book.

(3) Shareholders' Cash Book.

(4) Transfers or Transfer Register.

A suitable ruling for such a combined Register of Members and Share Ledger, which will be found to meet all the requirements of the Act set out previously in this chapter, is given on the opposite page.

(e) NO TRUSTS ON REGISTER. In order to save the complications that would arise if a company were bound to take notice of trusts, Sec. 27 of the Act provides that no notice of any trust, express, implied, or constructive, shall be entered on the Register of Members, or be receivable by the registrar, in the case of companies in England (which includes Wales) or Ireland.

## Address

Description

[illegible]

This means that the trustees, if they wish to have their position recognized by the company, must be registered in their own names and not in their representative capacity. Where they do not so register, the person in whose name the shares are registered would have complete control of them, that is to say, the company looks only to the person on the Register, except that the executors or administrators of a deceased's estate have a statutory right to sell or transfer the shares of the deceased, as is also the case with trustees in bankruptcy who have a statutory right to sell and transfer the shares of the bankrupt.

Where the trustee has shares registered in his own name he will be liable for any calls due on partly paid shares, but he will have a right to be indemnified out of the funds of the estate over which the trust exists.

It is specially provided by Sec. 11 of the Public Trustee Act, 1906, that the entry of the name of the Public Trustee on the Register does not constitute notice of a trust.

It will be observed that Sec. 27 applies only to England and Ireland, therefore trusts can be recognized in the case of companies domiciled in Scotland.

(f) RECTIFICATION OF REGISTER. It has already been stated that entries in the Register of Members are only *prima facie* evidence, but the secretary of the company has no power to alter the register by striking any name off, such power being vested in the Court by Sec. 32 of the Act. The Court has power under this section to rectify the Register as follows—

(1) Where the name of any person is, without sufficient cause, entered in or omitted from the Register of Members, or

(2) Where default is made or unnecessary delay takes place in entering on the Register the fact of any person having ceased to be a member.

The Court has exercised its power in the following cases—

(i) Where registration of a transfer has been improperly refused.

(ii) Where shares have been surrendered otherwise than in accordance with the Act.

(iii) Where a forged transfer has been registered.

(iv) Where the power to forfeit shares has been wrongly exercised.

Application may be made to the Court either directly under Sec. 32 or by action. The latter course is adopted where there is any opposition to the rectification.

Rectification can be effected even though the company is in liquidation, but it must be ordered by the Court, and not done by the liquidator on his own responsibility.

The secretary may, however, rectify mere clerical mistakes.

(g) REGISTRATION OF CHANGES. Lack of interest on the part of members in their holdings accounts very often for the large balance which appears on the liabilities side of many company balance sheets under the heading of "Unclaimed Dividends."

Shareholders should not, therefore, fail to give immediate notice to the company of any change in their address, otherwise dividends due to them may go to swell such balances, which become statute barred in twenty years, or may become forfeit to the company if not claimed within a period stipulated for in the Articles, and where calls are made on the shares it may very well be that failure to notify the change of address will lead to forfeiture of the shares for non-payment of the calls.

Some shareholders, however, go to the other extreme, and cause a great deal of trouble to secretaries or registrars by notifying temporary changes of address,



such as the address at which they are spending their holidays which, of course, is unnecessary.

Notification of marriage, accompanied by a copy of the marriage certificate, should also be given by lady shareholders.

No charge is made, as a rule, by companies for registering a change of address, but a charge of 2s. 6d. is usually made for registering the following—

- (1) Power of Attorney.
- (2) Probate or Letters of Administration.
- (3) Marriage.
- (4) Transfer of Shares.

All notifications of changes and requests for payments of dividend to bankers and others should be acknowledged by the registrar of the company, and carefully noted, preferably in red ink, in the Register.

(h) CLOSING REGISTER. A company is empowered by Sec. 31 of the Act to close the Register of Members for any time or times not exceeding in the whole thirty days in each year. This must be done by giving notice by advertisement in some newspaper circulating in the district in which the registered office is situated.

The usual form of such notice is as follows—

#### PUBLIC COMPANY, LTD.

Notice is hereby given that the TRANSFER BOOKS relating to the 6 per cent Cumulative Preference Shares of this company will be closed from the 17th to the 31st July, 192., both days inclusive (for the preparation of Dividend Warrants payable on the 1st August, 192.).

By Order of the Board.

E. SCRIBE,  
*Secretary.*

DIVIDEND HOUSE,  
GOLDEN STREET, E.C.2.  
30th June, 192..

If the books are to be closed for payment of a dividend this fact should also be stated in brackets in the notice as shown on page 166.

Notification of the closing of the books in respect of other classes of shares may also be incorporated in the one notice.

During the time the books are so closed no transfers can be registered, although certification of transfers may be carried on as usual.

(i) INSPECTION OF REGISTER. The Register of Members is required, by Sec. 30 of the Act, to be kept at the registered office from the date of registration of the company, but in practice, it is often kept at some other office. Where an outside person, such as the accountant to the company, is appointed registrar, the register would be kept at his office, which would be the transfer office of the company. Although such a practice is not legal there appears to be no objection to it as such an arrangement would be in the best interests of the company. There is no penalty attached to keeping the register at a place other than the registered office. It is evident, therefore, that; so long as adequate provision is made for its inspection by members and others, no one would be injured by the practice and there would consequently be no ground for complaint.

The register must be open, for at least two hours on each business day, to the inspection of members, free of charge, and to others on payment of one shilling or such less sum as may be prescribed by the regulations of the company, and any member or other person may require a copy of the register, or any part thereof, on payment of sixpence per hundred words or fractional part thereof required to be copied.

This charge of sixpence in no way covers the actual cost of the preparation of such lists, and as they are

continually wanted by outside brokers for touting purposes, the company or the person running the transfer office has to supply the copies of the register at a loss.

The right to inspect and require copies of the register ceases upon the company going into liquidation, and it is not available during the aforementioned period when the register is closed.

Failure to allow inspection or copies of the register renders the company and every director and manager who knowingly authorizes or permits the refusal, liable to a fine not exceeding £2 for every refusal, and to a further fine of £2 a day during which the refusal continues. In addition to which, in England or Ireland, any judge of the High Court may compel an immediate inspection of the register.

### **Register of Directors and Managers.**

Sec. 75 of the Act makes it compulsory for every limited company to keep a register in which to record the names, addresses, and occupation of its directors and managers, and the Companies (Particulars as to Directors) Act requires the additional information to be given as to any former christian names or surname, nationality, and nationality of origin.

A copy of this register, impressed with a five shilling fee stamp, must be filed with the Registrar of Companies, who must also be notified from time to time of any alterations or changes therein.

Any company not complying with these provisions, and every director or manager who permits or authorizes the default, is liable to a penalty of £5 for every day during which the default continues.

The Companies (Particulars as to Directors) Act, 1917, provides that the term "Director" for this purpose shall include any person who occupies the

position of a director, by whatever name called, and under whose directions or instructions the directors are accustomed to act. This provision was rendered necessary by the practice frequently indulged in by aliens of hiding their identity and controlling interest in the company in the names of nominees of British origin, thus leading investors, customers, and creditors to believe they were dealing with an entirely British company, and not one merely British by registration.

The Register of Directors and Managers should be ruled as shown on page 170.

### **Register of Mortgages and Charges.**

A Register of Mortgages and Charges specifically affecting the property of the company must be kept in accordance with Sec. 100 of the Act, and in it will be recorded a short description of the property charged, the amount of the mortgage or charge, and the names of the mortgagees or persons entitled to the charge. Particulars of the names of the mortgagees, etc., are not, however, required in the case of securities to bearer.

Every director, manager, or officer of the company wilfully authorizing the omission of any of these particulars renders himself liable to a penalty not exceeding £50.

The usual ruling for such register is as shown on page 170.

The right of members and others to inspect and make copies of the Register of Mortgages, and the penalties for refusal of this right have been dealt with in Chapter V.

### **Minute Books.**

Minute Books in which to record the proceedings at meetings of directors or shareholders must be kept to comply with Sec. 71 of the Act.

# REGISTER OF DIRECTORS AND MANAGERS

The present Christian name or names and surname.	Any former Christian names or surname.	Nationality.	Nationality of origin (if other than the present nationality)	Usual Residence.	Occupations.	Changes.

# REGISTER OF MORTGAGES AND CHARGES

No.	Date of Mortgage or Charge.	Short Description of Property Mortgaged or Charged.	Amount of Charge Created.	Name and Address of Mortgagee or Person entitled to the Charge	Date of Discharge of Mortgage or Charge.

These books should be written up by the secretary, who should see that any necessary alterations made in the minutes are initialed by the Director who signs them. Such alterations should be made only on the acquiescence of every director who attended the meeting, the proceedings of which the minutes purport to record.

The wisest course to adopt where such alterations are necessary is to effect them by another minute, passed at a subsequent meeting, as any other method or lack of method may lead to subsequent trouble.

Minutes signed by the chairman at the meeting at which the proceedings took place, or by the chairman of the next succeeding meeting, are evidence of the proceedings. They are not conclusive evidence, however, for it may be proved by oral evidence that any unrecorded resolution was in fact passed, but very convincing evidence would have to be produced before it would be allowed to upset the minutes as recorded and authenticated.

It is usual and convenient to keep separate minute books for directors' and shareholders' meetings, but in the case of small companies one book may be made to serve the double purpose.

### **Annual List and Summary.**

(i) **CONTENTS OF THE LIST.** Every company having a share capital is required by Sec. 26 of the Act to make a list at least once in each calendar year—

(a) Of all persons who, on the fourteenth day after the first or only ordinary general meeting in the year, are members of the company; and

(b) Of all persons who have ceased to be members since the date of the last return or, in the case of a first return, since the date of the incorporation of the company.

This list must state—

(1) The names, addresses, and occupations of all past and present members therein mentioned.

(2) The number of shares held by each of the existing members at the date of the return.

(3) The number of shares transferred since the date of the last return or, in the case of the first return, of the incorporation of the company.

(4) The dates of registration of such transfers.

(5) A summary distinguishing between shares issued for cash and shares issued as fully or partly paid up otherwise than in cash, and specifying the following particulars—

(a) The amount of the share capital of the company and the number of shares into which it is divided.

(b) The number of shares taken from the commencement of the company up to the date of the return.

(c) The amount called up on each share.

(d) The total amount of calls received.

(e) The total amount of calls unpaid.

(f) The total amount of the sums (if any) paid by way of commission in respect of any shares or debentures, or allowed by way of discount in respect of any debentures, since the date of the last return.

(g) The total number of shares forfeited.

(h) The total amount of shares or stock for which share warrants are outstanding at the date of the return.

(i) The total amount of share warrants issued and surrendered respectively since the date of the last return.

(k) The number of shares or amount of stock comprised in each share warrant.

(l) The names and addresses of the persons who at the date of the returns are the directors of the company, or occupy the position of directors, by whatever name called.

(m) The total amount of debt due from the company in respect of all mortgages and charges which are required (or, in the case of a company registered in Scotland, which, if registered in England, would be required) to be registered with the registrar of companies under this Act.

(n) A statement in the form of a balance sheet, made up to such date as may be specified in the statement, audited by the company's auditors, and containing a summary of its share capital, its liabilities and its assets, giving such particulars as will disclose the general nature of those liabilities and assets, and how the values of the fixed assets have been arrived at, but the statement need not also include a statement of profit and loss.

The Annual List of Members must be contained in a separate part of the Register of Members. A separate book is generally used for this purpose, being composed of bound copies of the official Form E.

The list must be completed within seven days after the fourteenth day aforesaid, and the company must forthwith forward to the Registrar of Companies a copy signed by the manager or by the secretary of the company. On default in complying with these requirements the company and every director and manager who knowingly authorizes or permits the default is liable to a penalty of £5 for every day during which default continues.

It will be seen that the List must be filed once in every calendar year, and it has been decided that this is so whether an ordinary general meeting has been held or not.

(ii) STATEMENT IN THE FORM OF A BALANCE SHEET. In preparing the required statement in the form of a balance sheet, the nature of the assets and liabilities must be clearly shown, that is to say, goodwill must



not be bulked together with assets, such as plant, machinery, or freehold buildings, but should be shown separately, and cash creditors should be distinguished from trade creditors. A copy of the last published balance sheet of the company is usually filed, and although there is no necessity to show the balance of Profit and Loss Account, this is always done. No object would be served in not disclosing it, as such balance would be represented by the difference between the two sides of the balance sheet. The assets and liabilities must therefore be grouped together in their respective classes.

It is anomalous that no provision is made that such statement in the form of a balance sheet should refer to the period covered by the List ; in fact there appears to be nothing to prevent the same statement being filed each year except the refusal of the registrar to accept them for filing purposes, though it is doubtful whether his refusal to do so could be upheld, as the Act merely requires a statement to be filed made up to such date as may be specified in the statement itself.

Private limited companies are not required to file this statement with the return.

### **Register of Transfers.**

Some form of Register of Transfers should be kept in which to record full particulars of all transfers, and from which the postings to the Register of Members can be made. The old form of bound book used for the Register of Transfers has fallen, to a great extent, into disuse, and has been replaced by the Guard Book, in which the transfers themselves are secured in numerical order. The postings to the Register of Members in this case are thus made direct from the original document, which eliminates the possibility of error, and saves checking and re-checking the work.

Separate Transfer Guard Books or Registers should be kept in respect of each class of share or debenture.

The transferor's and transferee's folio in the Register of Members should be recorded on the transfer for purposes of reference.

The method of carrying out a transfer of shares or debentures is fully explained in Chapter XI.

### Seal Book.

It is useful to keep a record in a Seal Book of all documents sealed. Authorization for the sealing of documents will, of course, be contained in the Directors' Minute Book, but unless a Seal Book is kept there will be no record that such documents have in fact been sealed.

The usual form of ruling for such a book is as follows—

Particulars of Document Sealed.	Date of Authorization for Sealing.	Minute Book Folio.	Date of Sealing.	Seal affixed in presence of	Document sent to

### Directors' Attendance Book.

Occasionally disputes arise as to whether directors were present at a certain board meeting or not, and in order to obviate such disputes a Directors' Attendance Book should be used. The date and particulars of the board meeting should be set out at the head of each page, the directors signing in the space provided below. Where a director leaves before the meeting is over this fact should also be recorded.

Persons in attendance, such as the solicitor and

auditor to the company, should also be asked to sign as having been in attendance.

### **Application and Allotment Sheets or Book.**

It is advisable, in the first instance, to obtain ruled and printed sheets to record full particulars of the amounts due and received from applicants and members on application and allotment of shares. The same sheets may also be ruled to provide for the record of any instalments or calls. As the work entailed in a public issue cannot usually be estimated, and must be carried out expeditiously, it will readily be seen that the use of sheets instead of a bound book will allow the work to be spread over many more members of the staff. It is suggested, however, that as soon as the work on the Allotment Sheets is complete, they should be bound into book form, thus preserving them as a permanent record.

The Application and Allotment Sheets or Book form the posting medium to the debit side of the Cash Account part of the Register of Members and Share Ledger shown on page 163.

The method of dealing with the application for and allotment of shares is fully considered in the next chapter.

The Allotment Sheets are very often also ruled to do the duty of a Shareholders' Cash Book, but this is not recommended. A separate book should be used for this purpose. A Cash Book reference folio should be recorded on the Allotment Sheets, so that it can be readily seen from such sheets whether instalments have been paid without constant reference having to be made to the Cash Book.

Where different classes of shares are issued separate Application and Allotment Sheets should be used for each class.

Similar sheets would also be used in the case of an issue of Debentures or Notes.

A suitable ruling for Application and Allotment Sheets is shown on page 178.

### **Shareholders' Cash Book.**

A Shareholders' Cash Book should be used to record the cash received from or returned to applicants and members.

Arrangements will be made with the bank to keep distinct accounts for application, allotment, and various instalments or calls, and the Cash Book should contain separate cash accounts for each.

This Cash Book will be the posting medium to the credit side of the Cash Account portion of the Register of Members and Share Ledger shown on page 163.

The ruling of this Cash Book will be the ordinary journal ruling.

### **Share Certificate Book.**

Share Certificate Books should be printed in different coloured ink for each class of share.

Sec. 92 of the Act provides that every company shall, within two months after the allotment or registration of transfer of any of its shares, complete and have ready for delivery the share certificates, unless the conditions of issue of the shares otherwise provide, under penalty of five pounds, for every day during which the default continues, on the company and every director, manager, secretary, or other officer of the company who is knowingly a party thereto.

It will be observed that the Articles or the Prospectus may extend or shorten the period of two months from allotment or registration of transfer, within which Sec. 92 requires the share certificates to be ready for delivery.

SHARES

[illegible]

Date sent: \_\_\_\_\_

Received Certificate No. .... for.

*Signature.*

*Date.*

No. OF SHARES

DIVIDED INTO 300,000 CUMULATIVE PARTICIPATING PREFERENCE SHARES OF £1 EACH DISTINCTIVE NOS. 1 TO 300,000 (INCLUSIVE), AND 100,000 ORDINARY SHARES OF £1 EACH DISTINCTIVE NOS. 1 TO 100,000 (INCLUSIVE) AND 200,000 ORDINARY SHARES OF 10/- EACH DISTINCTIVE NOS. 100,001 TO 300,000 (INCLUSIVE).

The said Preference Shares are entitled to a fixed Cumulative Preferential Dividend at the rate of 7½ per cent per annum and to a right after the Ordinary Shareholders shall have received a Non-Cumulative Dividend for that year at the rate of 10 per cent to share *pro rata* with the Ordinary Shareholders in the surplus profits of such year which it shall be determined to divide up to a further 2½ per cent for such year any balances of such profits to go to the Ordinary Shareholders and the right in a winding-up to payment of all Capital and areas of fixed dividend whether declared or not up to the commencement of the winding-up in priority to the Ordinary Shares.

This is to Certify that \_\_\_\_\_ of \_\_\_\_\_ is the Registered Holder of \_\_\_\_\_ Cumulative Participating Preference Shares of One Pound each fully paid, numbered as per endorsement inclusive in \_\_\_\_\_

subject to the Memorandum and Articles of Association of the said Company.

Given under the Common Seal of the Company

this day of 192

~~SECRETARY.~~

No transfer of the above Shares or any of them will be registered unless this Certificate has been delivered at the Company's office and the Certificate must be surrendered before any deed of transfer, whether for the whole or any portion thereof, can be registered or a new Certificate issued in exchange.

[illegible]



It is preferable to endorse the distinctive numbers on the back of the certificate, and provision should also be made thereon, where certificates are issued in respect of partly paid shares, for the endorsement of further payments.

The authority of the shareholder or debenture holder should be obtained before sending certificates through the post; this will usually be done by sending out a notice to the effect that certificates are ready for delivery.

The form of certificate appearing between pages 178 and 179 has been found in practice to be very useful where the shares are issued fully paid.

Share certificates should only be issued in exchange for allotment letters, transfer receipts, or balance receipts.

The effect of the issue of the certificate is considered on page 255.

### Notice of Transfers Lodged Book.

In order to prevent the shares of a member being sold without his knowledge or acquiescence, and as a safeguard against fraud, it is usual to send to the transferor some such advice as the following—

#### THE PUBLIC COMPANY LIMITED

*Transfer Office—*

DIVIDEND HOUSE,  
GOLDEN STREET, E C 2.  
..... 19..

No. ....

.....  
.....  
.....

Dear Sir,

We beg to inform you that the following Transfer(s) from your name and purporting to be signed by you



ha.. been lodged at this office for registration, and that unless we hear from you to the contrary by return of post, the same will be passed by the Board in the usual way—

Transfer No	No. of Shares.	Transferee.

Yours faithfully,

.....  
Registrars.

The pages of this book will be printed in duplicate ; the original being sent to the transferor and the carbon copy retained in the book for future reference.

### **Transfer Receipt Book.**

A counterfoil book, known as the Transfer Receipt Book, printed as follows, is used to acknowledge the receipt of all transfers, and will be exchanged at a later date for a share certificate. The particulars contained on the receipt will also be shown on the counterfoil.

### **THE PUBLIC COMPANY LIMITED** **TRANSFER OF SHARES**

DIVIDEND HOUSE,  
GOLDEN STREET, E.C.2.

Transfer Hours

11 to 2

Saturdays excepted.

No.....

Transfer(s) as under ha.. been lodged at this office

for Registration (subject to the approval of the Directors) by .. .. .

Transferor	Transferee.	Number of Transfer.	Number of Shares.

Registration fee £ s. d. paid.

Certificates will be ready on or after .. .. .

Signed for the Company,

.....  
Registrars.

### Balance Ticket or Receipt Book.

A shareholder who transfers part of his holding is usually entitled, after registration of the transfer, to a fresh certificate in respect of the balance of his holding not transferred. In some cases, however, although not recommended, a new certificate is not so issued, the particulars of the transfer of shares and the balance held being merely endorsed on the back of the old certificate, which will be returned to the transferor after registration has been effected. In both cases, as some time usually elapses before registration of the transfer is effected, in order to allow the transferor to deal in the balance of his shares in the interim, a Balance Ticket or Receipt is issued on lodgment of the original share certificate with transfer for certification or, where the transfer has not been so lodged, then on lodgment for registration. This ticket or receipt will temporarily take the place of the share certificate, and will later be exchanged for a new balance certificate or for the old certificate duly endorsed as before mentioned.

Counterfoil Balance Receipt Books are used to meet

such cases, particulars of the receipt being retained in the book on the counterfoil.

The following is the usual form of Balance Receipt—

### THE PUBLIC COMPANY LIMITED

*Transfer Office—*

DIVIDEND HOUSE,  
GOLDEN STREET, E C 2.

No. . . .

Transfer Hours 11 to 2

Saturdays excepted.

Received from . . . . .  
Share Certificate No. . . . . in favour of . . . . .  
. . . . . for . . . . . shares  
deposited against Transfer for . . . . . shares

Leaving balance of

Registrars.

### Transfer Fees Book.

The Transfer Fees Book, in which the Transfer Fees, Registration of Probate and Marriage Fees are recorded will be ruled thus—

Date	Transfer No.	From whom received.	Amount.				Remarks.

Where, however, the transfer office is run by some outside person as registrar, such as the accountant to the company, the fees usually recorded in this book will, as a rule, be payable direct to such registrar, in which case they will not be entered in the company's books or accounts, and consequently a Transfer Fees Book would not be required by such a company.

It is submitted that it would be incorrect, in such a case as the foregoing, to show the transfer fees in the company's Profit and Loss Account as income, and to equalize this on the debit side of that account by charging the same as remuneration of the registrar, because in effect the company has no right to receive the transfer fees as it has assigned its right in this respect to the registrar in consideration of his services. Where, however, the registrar is to be paid a sum equal to the transfer fees and the right to receive the actual fees is not assigned to him, the position would be otherwise.

### FINANCIAL BOOKS

The company should arrange for its professional accountant to prepare and supervise the installation of a proper system of accounting. The Purchase Agreement will usually provide that the books of the concerns to be purchased are to become the property of the new company on completion, but it may, nevertheless, be necessary to scrap all such books and revise the system of accounting.

Where the purchase consideration is one lump sum, before the books can be opened it will be necessary for the directors to allocate such consideration to the various assets. This will be done at a board meeting, and a record of the allocation will be made in the minute book, upon which the accountant should raise the necessary entries in the books to give effect to the same. Regard should, however, be paid to the remarks made on page 36 as to the allocation of the purchase consideration.

The various points to be dealt with in the financial books with regard to share capital are referred to in their proper places throughout this book. The nature of the financial books will depend upon the class of

business itself, and consequently cannot be fully dealt with here, but it may be stated that all systems of accounting should provide an adequate check on and control of cash receipts and payments, wages, stores, purchases and sales, and should be so organized as to facilitate the preparation of intelligent manufacturing, trading, and profit and loss accounts for each year, and a balance sheet showing the position as on the last day of the financial year.

## BALANCE SHEETS AND ACCOUNTS

The requirements of the Act in respect to the audit and signature of balance sheets have been dealt with in Chapter VIII, but here it is intended to consider the balance sheet and accounts from an accountancy and shareholders' point of view.

### **Condensation of Published Accounts.**

It is a fact, as often alleged by directors, that the publication of much detail relating to the Profit and Loss Account may afford competitors of the company information which might be damaging to the company issuing it.

This fact has been taken advantage of by directors to such an extent that where a so-called Profit and Loss Account is submitted to shareholders, it is so condensed as to be of little or no value to them and, generally speaking, is not a Profit and Loss Account at all, but is merely what is known to accountants as a Profit and Loss Appropriation Account, which deals only with the appropriation of the profit and does not show how it is made up. There is, however, a great deal to be said in favour of condensing the Profit and Loss Account as much as possible for the purposes of publication.

There is not, however, so much to be said in favour of the unfortunate practice adopted by many companies of issuing balance sheets condensed to such an extent that the relative book values of the assets and the nature of the liabilities cannot be ascertained therefrom. It cannot be alleged that the balance sheet, if framed in detail, would afford any very valuable information to competitors, for there is no item contained therein which reflects the nature of the company's trading operations as the balance of Profit and Loss Account, which cannot be bulked with creditors or assets, and must be shown separately, merely shows the result of such trading. Balance sheets have been known to state in one item "Sundry Creditors, Reserves, and Balance of Profit and Loss Account," but such a practice should be vehemently protested against by shareholders.

Very little is to be gained by the condensation of the balance sheet of a public company, except from the point of view of hoodwinking the shareholders or of a possible saving in the cost of printing, for the "Statement in the form of a Balance Sheet" which has to be filed with the Annual List and Summary must give full information as to the nature of the assets and liabilities, except in the case of holding companies, which are dealt with later, and is open to the inspection of anyone, including creditors and competitors, who cares to take the trouble of going to Somerset House for the purpose. A Profit and Loss Account is not so required to be filed, nor need such statement in the form of a balance sheet contain any reference to the balance of the Profit and Loss Account, although there is no difficulty in ascertaining this figure, as already shown in this book.

The production of a detailed balance sheet stimulates the interest of the shareholders in the company, but

over-condensed balance sheets may anger them, if their shares are without dividend, or may arouse suspicion on their part even though they be receiving dividends.

### **Form of Balance Sheet.**

Directors of companies should be guided by the company's professional accountant as to the form of the balance sheet, and the order in which the assets and liabilities should be shown therein.

No standardized form of balance sheet is required under the Companies Acts, 1908 to 1917, although from the investors' point of view a standardized balance sheet might be an advantage.

The balance sheets and the revenue accounts of insurance companies, however, have both been standardized under the Assurance Companies Act, 1909. In the case of railway companies not only has the balance sheet and revenue account been standardized by the Railway Companies (Accounts and Returns) Act, 1911, but the preparation of certain statistical returns have also been provided for on a uniform basis under that Act.

In the case of railway companies, and certain other statutory companies, the balance sheet is not prepared on the same lines as a commercial balance sheet, but is drafted on what is termed the "Double Account System," under which the balance sheet is prepared in two parts.

We are not, however, concerned in this book with companies working under an Act of Parliament other than the Companies Acts, 1908 to 1917.

Whatever method be adopted as to the order the assets and liabilities appear on the balance sheet, regard should be paid in all cases to the following principles—

## I. ASSETS.

(a) Fixed assets should never be bulked together with floating assets.

(b) Non-depreciating assets (if any) should be separated from depreciating assets.

(c) Intangible assets, such as goodwill or trade marks, should always be shown separately from other assets.

(d) Trade debtors should be distinguished from cash debtors, that is to say, loans, and amounts due from directors or other persons standing in fiduciary relationship towards the company should be separately stated.

(e) Bills receivable should be distinguished from debtors, cash, and investments.

(f) Stock-in-trade should appear as a separate item and not amalgamated with any other liquid asset.

(g) Investments and cash should not be shown in one item. The nature of the investments should be indicated and shares held in subsidiary companies should not appear under the heading of investments.

(h) It should be clearly shown whether the assets are included at cost price or whether proper depreciation has been provided for.

## 2. CAPITAL AND LIABILITIES.

(a) The authorized or nominal capital and the issued capital should be clearly shown, distinguishing between the different classes of shares, and calls in arrear should be shown as a deduction from the issued capital.

(b) Secured creditors, e.g. mortgage debentures, should not be bulked with amounts due from unsecured creditors, e.g. naked debentures or notes.

(c) Cash creditors, e.g. bank overdraft or cash loans, should be separately stated from trade creditors.

(d) Bills payable should be distinguished from trade creditors.

(e) Unclaimed dividends should not be included in the item of trade creditors.



(f) Amounts owing to directors or other persons standing in fiduciary relationship towards the company should also be shown separately.

(g) Any contingent liabilities, such as amounts remaining uncalled on the company's investments or holdings, should be shown as a note at the foot of the liabilities side of the balance sheet.

(h) Generally speaking, specific reserves should be shown as a deduction from the asset affected, and general reserves should be shown under that heading on the liabilities side of the balance sheet, and not bulked together with creditors or the balance of Profit and Loss Account.

Sometimes, however, what are termed "Secret Reserves" are created by writing down assets to a lower figure than their true value or by overstating the liabilities, and not disclosing this in the balance sheet at all. The extent to which such a practice may be allowed without comment in the auditors' report will depend upon whether such reserve has been created for a legitimate purpose in the interests of the company, or whether it has been created to enable directors to manipulate profits, in which latter case, or in any case if the reserve is excessive, a note of the reserve should be made upon the balance sheet or referred to in the auditors' report, otherwise such balance sheet cannot be said to show the true and correct state of the company's affairs. In other cases than the foregoing, if the position as disclosed by the balance sheet is less favourable than the true position, then apparently the auditor need not make any disclosure of the reserve.

### **Balance Sheets of Holding Companies.**

Companies which are formed for the sole purpose of acquiring, or companies which are in existence and

acquire, the controlling interest in the share capital of one or more other companies are known as "holding or parent companies."

The companies over which the holding company has control are known as "subsidiary companies." The subsidiary companies may, however, be themselves holding companies.

The sole *raison d'être* of the holding company may be merely to hold the shares of its subsidiaries, or at least three-fourths of them, or it may, in addition, carry on business itself.

The holding company will probably be a public company, though it may be a private company, while the subsidiary companies will probably be private companies, though they may be public companies. The directors of the parent company are usually well represented by a majority on the boards of the various subsidiaries.

Holding companies may have as many subsidiary companies as they desire. It is not, therefore, difficult to imagine the extreme case of a public company holding a controlling interest in one hundred subsidiary companies, all of which may be private companies, each being a distinct legal entity apart from its parent company, and all of them owing their existence almost entirely to the capital subscribed by the shareholders of the parent company, which capital has been utilized to acquire the controlling interest in such subsidiaries.

What then is the result of such a case from the point of view of the shareholder in the parent company? This unfortunate person is dependent for information as to the use his money is being put to entirely upon any information the directors of his company may give him in their report, for he is only entitled, as a rule, to receive the balance sheet of the parent company, which will probably show as its chief asset the item

"Shares in Subsidiary Companies," and he will not be entitled to receive the audited balance sheets of the subsidiary companies with which he could check the valuation placed upon such shares.

If all the subsidiary companies are public companies the shareholders of the parent company may take the trouble to inspect the statements in form of balance sheets, which would have to be filed at Somerset House, and so glean information, but, in the imaginary case cited above, all the subsidiaries are private companies, and consequently in that case this source of information is closed to them, for private companies do not have to file such a statement in the form of a balance sheet.

Such a state of affairs should be remedied either by legislation making it compulsory, where a company holds more than, say, one half of the capital of another company, for such latter company to supply a copy of its balance sheet to every shareholder in the former company or alternatively by a similar provision in the Articles of the subsidiary companies.

In any case, the parent company should take steps to acquire power to give more information to its own shareholders in explanation of the item "shares in subsidiary companies" than is the case at present. This could be done in any one of the following ways by providing the shareholders of the parent company with—

(1) Copies of the balance sheets of all the subsidiary companies, distinguishing in each the capital held by the parent company from that held by others, together with the parent company's own balance sheet; or

(2) An amalgamated balance sheet of all the subsidiaries, distinguishing therein the total capital held by the parent company from that held by others, together with a copy of the parent company's own balance sheet; or

(3) A combined balance sheet of the holding company and all the subsidiary companies in which the assets and liabilities of all would be set out with as much detail as possible. In this case the item "Shares in Subsidiary Companies" might very well be eliminated from such balance sheet, at the same time eliminating the corresponding items, on the liabilities side, of share capital and premium on shares account (if any), and the difference remaining might then be shown under the heading of suspense account on the assets or liabilities side according as to whether the valuation of the item "Shares in Subsidiary Companies" is in excess of the equivalent share capital or vice versa respectively.

The first method might be too expensive to adopt, and also the average shareholder would not have the necessary knowledge to enable him to amalgamate the results ; for these reasons either the second or the third method is recommended.

The third method, in which the subsidiaries are treated as branches of the parent company, has the advantage of showing quite clearly the relation of the assets and liabilities of the companies as a whole to the capital of the parent company, and the capital held in the subsidiaries by persons other than the parent company.

The end of the financial period of each subsidiary company must, of course, coincide with that of the holding company.

There are other ways of dealing with this matter, but it is submitted that any one of the above would provide the shareholders of the holding company with the necessary information to enable them to ascertain how the money subscribed by them is represented.

## CHAPTER X

### PUBLIC ISSUE OF CAPITAL

WHILE the solicitor is busy obtaining registration of the company, completing purchase and service agreements, and preparing the final draft prospectus, the promoter must concentrate upon the arrangements necessary for the issue of capital to the public. He will, therefore, have been busy in the City making good use of the reports of the valuers and accountant and a draft copy of the prospectus, in the endeavour to secure the services of a firm of stockbrokers with a name which will inspire confidence on the part of the London and Provincial Stock Exchanges and underwriters, with a view to obtaining the underwriting of the issue. Arrangements must also be made for advertising the prospectus. This is usually placed in the hands of some well-known firm of advertising agents.

Alternatives will be open to the company with regard to the public issue of capital. It may be decided either—

- (1) To issue a prospectus to the public direct; or
- (2) To place the issue in the hands of an issuing house of repute, who will either buy the shares or debentures, as the case may be, from the company, and make an offer of them for sale to the public, or offer them to the public on behalf of the company.

The company or the issuing house, whichever undertakes the issue, may or may not then decide to get the issue underwritten.

## UNDERWRITING

**The Nature of Underwriting.**

It is now a common practice for directors to ensure the success of a public issue of shares, debentures, etc., by getting some responsible person or persons to underwrite it. That is to say, these persons, called "Underwriters," will agree to take up and pay for any shares of the issue underwritten by them which have not been subscribed for by the public up to a certain date, the consideration for which service is usually the payment of a commission termed "Underwriting Commission." The underwriting agreements usually stipulate that applications bearing the stamp of the underwriters shall go in reduction of their individual underwriting, and that any public applications, outside the foregoing, shall go in relief of the liability of all the underwriters rateably in proportion to the amounts underwritten by them respectively.

Sometimes the consideration for underwriting takes the form of an option to call for shares at par or at a premium up to a specified date. This was held to be perfectly legal in the case of *Hilder v. Dexter*, 1902, even where there was no authority in the Articles for such option.

Underwriting is, then, in the nature of an insurance against the risk of under-subscription of the issue by the public.

If the issue is a success the underwriters take their commission, and are freed from the obligation to take shares, etc., but if the issue is under-subscribed the underwriters, although they are still entitled to their commission, must subscribe and pay for their respective proportion of the shares not applied for by the public. In the latter case they will probably form a pool of

the shares, and gradually dispose of them through such pool to the general public.

Underwriting commission is, therefore, a commission paid to a person who agrees by contract, in consideration for such payment, to take the whole or part of the shares or debentures not subscribed for by the public.

It was at one time considered to be a sign of lack of faith in the concern to have an issue underwritten, and the statement that "no part of this issue has been or will be underwritten" was printed boldly in any prospectus dealing with an issue of shares or debentures. The reverse is now, usually, considered to be the case, and where an issue has not been underwritten it may generally be assumed that underwriters could not be found who would undertake the risk at a reasonable commission, but there are, of course, exceptions to this rule.

### **Over-riding.**

The company may decide to put the underwriting in the hands of one or more persons who, in consideration of the payment of a commission, termed over-riding commission, agree to procure underwriting for the issue. This commission is payable only if the underwriting is procured.

In practice, however, it will be found that over-riding commission is in the nature of an increased underwriting commission, as, more often than not, it is payable to the underwriters themselves as an additional inducement to accept underwriting. It is, however, usually less than the amount payable under the style of underwriting commission.

### **Sub-Underwriting.**

The underwriters very often cover themselves by entering into sub-underwriting agreements with others

who, for a commission paid to them by the underwriter, agree to relieve him of his liability to take up the whole or a proportion of any shares he would be liable to take up in the case of under-subscription by the public.

The company will, however, continue to look to the underwriter and not to the sub-underwriter for satisfaction if the shares, etc., offered are not fully subscribed. In such a case the underwriter will request the company to make the allotment direct to his nominees, who will be the sub-underwriters.

### **Underwriting Contract.**

The underwriting contract is usually embodied in what is termed an "Underwriting Letter," which may be either by deed or merely in writing. There appears to be nothing, however, to prevent an oral underwriting agreement except possible subsequent difficulty in supplying evidence of the agreement should a dispute arise. Where the underwriting letter is by deed it must be stamped with a 10s. stamp; if merely in writing, then by a 6d. agreement stamp.

The underwriting contract cannot be too carefully drawn up, as underwriters sometimes endeavour to avoid meeting their liability if loop-holes are provided in the underwriting letters, and it is also advisable, where underwriting has been offered on a draft prospectus, to see that the underwriters are put in possession, as soon as possible, of a copy of the final prospectus as issued to the public, especially where the terms of the latter differ materially from the former.

The underwriting letter is usually framed as an offer to underwrite, and requires the company's acceptance. It can, however, be framed as an acceptance of an offer made by the company. The former is the more usual method. The ordinary rules of the law of contract as to offer and acceptance apply,



and it must, therefore, be remembered that the offer can be withdrawn at any time before acceptance, and may be conditional, but the acceptance of the offer must be unconditional.

Where the underwriting letter is signed by an agent the company is put upon inquiry as to the agent's authority, and in consequence it will, usually, be necessary to have evidence of it.

The following is the usual form of Underwriting Letter—

### THE PUBLIC COMPANY, LIMITED

---

CAPITAL . . . . . £700,000

Divided into

300,000 7 per cent Cumulative Preference Shares of £1 each, and 400,000 Ordinary Shares of £1 each.

---

### ISSUE OF

300,000 7 per cent Cumulative Preference Shares of £1 each, at par, and  
400,000 Ordinary Shares of £1 each at 21/6 per share.

---

*To the Directors,*

THE PUBLIC COMPANY LIMITED.

Gentlemen,

1. With reference to the draft Prospectus, dated the . . . . . day of . . . . . 19 . . . , and marked "Draft—subject to revision," which when finally settled you propose to issue, and for the consideration below mentioned, I/we, the undersigned, hereby underwrite . . . . .  
 Preference Shares {  
 Ordinary Shares { of the above shares so to be offered, and I/we now hand you (an) application(s), for the same together with cheque for £ . . . . . for payment of the deposit of . . . . . per share payable on the shares underwritten by me/us, which is to be applied accordingly.

2. My/our subscription is to be on the terms of your Prospectus as finally settled and filed with the Registrar of Companies, and you are at liberty to insert the date of such Prospectus in my/our application.

3. If the whole of the said 300,000 7 per cent Cumulative Preference Shares and 400,000 Ordinary Shares in your capital shall be applied for by and allotted to the public I/we are not to be allotted any shares in respect of our application; but if the whole of the shares so to be offered of a class hereby underwritten be not so applied for and allotted then all applications made by the public for shares of such class on which allotments are made are to be applied in relief of the underwriters of shares of that class including myself/ourselves rateably in proportion to the number of shares of such class underwritten by them respectively. Provided always that if any of the underwriters shall under Clause 4 of the underwriting letters subscribe or procure subscriptions of shares of a class for amounts in excess of the amounts of such class they would but for this proviso have to take up, then the excess shall be applied in relief of the underwriters of such class who have not completely relieved themselves under Clause 4 and in proportion to the amounts underwritten by them respectively.

4. All applications for shares of a class hereby underwritten stamped or initialed by me/us and approved by you sent in prior to the time fixed by the Prospectus for closing the list of subscribers are to be applied primarily in relief of my/our obligation to subscribe hereunder for shares of such class, and shall not be considered subscriptions by the public.

5. If I/we withdraw or do not hand you the above-mentioned application(s) you are at liberty to authorize any one of your officers in my/our name or on my/our behalf to sign and put in (an) application(s) in the form referred to in the prospectus as published for the number of shares of the class underwritten by me/us or any less number which I am/we are liable to take hereunder, and to take an allotment in respect thereof, and I/we will pay the allotment money immediately after receiving notice of allotment, and this provision is to be irrevocable.

6. You are within seven days after you shall have duly allotted the said shares so to be offered by you to pay to me/us an underwriting commission of 9d. per share in cash on the number of shares underwritten by me/us, such underwriting commission to be paid whether I am/we are required to accept an allotment of shares or not; but if an allotment be made to me/us no underwriting commission is to be payable until the allotment moneys payable by me/us have been paid, and you may apply the commission in or towards payment of such moneys.

7. My/our obligation hereunder is to hold good notwithstanding any variation between the draft Prospectus submitted to me/us as above referred to and the Prospectus as finally settled and published, provided that the amount of the capital of the company namely, £700,000, divided into 300,000 7 per cent Cumulative Preference Shares of £1 each and 400,000 Ordinary Shares of £1 each, is not altered.

8. Any notice to me/us may be served by sending the same by post addressed to me/us at the subjoined address, and shall be

deemed to be served on the day following that on which it is posted.

Be so good as to notify me/us your acceptance of this proposal.

Dated this.... .. day of .. ..... . 19..

*Signature of Underwriter* .. . . .

*Address* . . . . .

.. . . .

We accept the above.

For and on behalf of

*Date* ...

19...

THE PUBLIC COMPANY LIMITED

An application form marked " Underwriting " should be signed by the underwriter and lodged with the company together with the underwriting letter.

### **Conditions under which Underwriting Commission and Other Commission can be Paid.**

Sec. 89 of the Act provides that the aforementioned commissions may be paid by a company only if—

(a) The payment is actually a commission. That is to say, it must not be a mere subterfuge for the sale of shares at a discount which is illegal. The payment of the commission must therefore be made in respect of some agreement other than that to take an allotment of shares.

(b) The payment is authorized by the Articles.

(c) The payment does not exceed the amount or rate so authorized.

(d) The amount or rate agreed is disclosed in the prospectus or statement in lieu of prospectus.

The provisions of Sec. 89 of the Act are as follows—

89.—(1) It shall be lawful for a company to pay a commission to any person in consideration of his subscribing or agreeing to subscribe, whether absolutely or conditionally, for any shares in the company, or procuring or agreeing to procure subscriptions, whether absolute or conditional, for any shares in the company, if the payment of the commission is authorized by the articles, and the commission paid or agreed to be paid does not exceed the amount or rate so

authorized, and if the amount or rate per cent of the commission paid or agreed to be paid is—

(a) In the case of shares offered to the public for subscription, disclosed in the prospectus ; or

(b) In the case of shares not offered to the public for subscription, disclosed in the statement in lieu of prospectus, or in a statement in the prescribed form signed in like manner as a statement in lieu of prospectus and filed with the Registrar of Companies, and, where a circular or notice, not being a prospectus, inviting subscription for the shares is issued, also disclosed in that circular or notice.

(2) Save as aforesaid, no company shall apply any of its shares or capital money either directly or indirectly in payment of any commission, discount, or allowance, to any person in consideration of his subscribing or agreeing to subscribe, whether absolutely or conditionally, for any shares of the company, or procuring or agreeing to procure subscriptions, whether absolute or conditional for any shares in the company, whether the shares or money be so applied by being added to the purchase money of any property acquired by the company or to the contract price of any work to be executed for the company, or the money be paid out of the nominal purchase money or contract price or otherwise.

(3) Nothing in this section shall affect the power of any company to pay such brokerage as it has heretofore been lawful for a company to pay, and a vendor to, promoter of, or other person who receives payment in money or shares from a company shall have and shall be deemed always to have had power to apply any part of the money or shares so received in payment of any commission, the payment of which, if made directly by the company, would have been legal under this section.

Sec. 90 of the Act also requires all sums paid by way of commission to be stated separately in the balance sheet until written off.

These provisions do not affect the payment by the underwriter of sub-underwriting commission, and consequently such commission need not be stated in the prospectus.

## BROKERAGE AND COMMISSION ON PLACING SHARES

Brokerage is the term applied to the commission

paid by companies to brokers or other recognized agents in respect of allotments made to applicants whose application forms bear the stamp of the broker or agent. If no allotment is made to the applicant the brokerage is not payable.

Brokerage is to be distinguished from "Commission on placing shares" in that it is payable usually under the terms of a prospectus which contains a general offer made by the company to all usual agents, which is accepted by such agents as soon as the form bearing their stamp is filled in and posted by the applicant or his agent.

Commission on placing shares is a commission paid by the company to persons who agree either to subscribe for shares themselves or to obtain subscriptions from others, but which is paid usually on the exercise of an option given to the agent by the company to call for certain shares over a given period and not on applications made in respect of a public issue.

If the shares are not placed the commission is not payable.

The payment of these commissions undoubtedly allows shares to be issued at a discount, for while it would be illegal to issue a £1 share fully paid for 15s., and if such share was issued on these conditions the allottee would remain liable to pay the balance of 5s., yet the same effect can be obtained, without any remaining liability, by issuing the share for £1 and paying a commission of 5s. It would, of course, be safer to make the payments separately, that is to say, the agent should give the company a cheque for the full amount of the shares, and the company should at the same time pay the commission, otherwise the transaction might be considered a subterfuge for the issue of shares at a discount, for the doctrine of set-off does not apply in this case, as a debt payable by the

company cannot be set-off against a debt due from a shareholder in his capacity as a member.

## PROSPECTUS

### Nature and Definition of Prospectus.

An issue, by a public company, of shares or debentures to the public is nearly always made by means of a document termed a "Prospectus," and all public companies must file with the Registrar such a document, or, in the case of a company not originally making a public issue, a Statement in lieu of Prospectus, before any shares or debentures can be allotted.

There appears to be nothing in the Act to prevent a prospectus being issued to the public before the company is formed, although such a course is very rarely adopted in present times, except in the case of doubtful concerns where the promoters have not sufficient confidence in them to lay out the moneys necessary for capital duty, etc., payable on registration.

It has been decided that, in the case of a reconstruction, an offer of shares in the new company to members of the old company does not constitute an offer to the public, and Sec. 81 (7) of the Act provides that this section shall not apply to a circular or notice inviting existing members or debenture holders of a company to subscribe either for shares or for debentures of the company, whether with or without the right to renounce in favour of other persons. Private companies may, therefore, make such offers, although they are precluded by their constitution from offering shares or debentures to the public.

A prospectus is defined by Sec. 285 of the Act as "any prospectus, notice, circular, advertisement, or other invitation, offering to the public for subscription or purchase any shares or debentures of a company."

A Bill is now before Parliament, however, to enlarge

the scope of this definition, under the short title of The Companies (Offers for Sale) Act, 1924, which provides for the inclusion, in addition to the foregoing, of "any advertisement, circular letter, notice, or other invitation to the public offering for sale any securities of any company whether such company is registered or not." This alteration has been rendered necessary in the interests of public protection by making the statutory requirements as to the particulars to be disclosed in a prospectus apply equally to an issue made by way of an "Offer for Sale" through some person, firm, or company, not connected with or concerned in the promotion of the company making the issue.

"Offers for Sale" have been frequently used as a means of avoiding compliance with the provisions of Sec. 81 of the Act, although the Stock Exchange has done much to prevent use being made of this loophole by insisting, in many cases, upon the publication of the information required by that section as a condition precedent to granting permission to deal in the securities or granting a quotation in the Stock Exchange Official List.

### **Contents of Prospectus.**

(a) DRAFTING PROSPECTUS. The prospectus cannot be too carefully drafted, as it forms the basis of the contract to take the securities offered, and any faulty wording might, in consequence, have the effect of such contract being set aside. The information intended to be supplied in the prospectus will usually be settled by the promoter, but the actual drafting of the prospectus should be left entirely to solicitor and counsel.

The promoter and directors of the company may give as much information as they like in the prospectus,

but they must believe it to be true, and have reasonable grounds for so believing, or it must be founded upon the reports of experts. They must, however, give the information required by Sec. 81 of the Act, which provides for the inclusion of certain information in every prospectus issued—

(1) By or on behalf of a company ; or

(2) By or on behalf of any person who is or has been engaged or interested in the formation of the company.

It will be seen from this that the provisions of Sec. 81 do not apply to an offer for sale made by some person or persons not connected with or interested in the formation of the company, provided he or they issued the prospectus, making the offer, on their own responsibility. As already stated, a Bill has been brought forward in Parliament by Mr. A. M. Samuel, M.P. to block up this loophole. The provisions of the bill as it now stands are as follows—

(i) In the Companies (Consolidation) Act, 1908, the expression “ prospectus ” shall mean, in addition to the meaning assigned to it in Sec. 285 of the said Act, any advertisement, circular letter, notice, or other invitation to the public offering for sale any securities of any company, whether registered or not ; and such provisions of Sec. 81 of the said Act as are relevant shall apply to every such offer for sale unless the company or person offering the securities for sale has had continuous possession of the securities for a period not less than two years immediately preceding the date of the offer for sale.

(ii) Any person authorizing the publication of any such advertisement, circular letter, notice or other invitation to the public shall be deemed to be a promoter for the purposes of Sec. 81 of the Companies (Consolidation) Act, 1908.



(iii) This Act may be cited as the Companies (Offers for Sale) Act, 1924.

This bill has not yet been placed upon the Statute Book, but it is to be hoped that, in the interests of the investor, it will be passed into law at an early date without amendment, as anything less would provide further loopholes for astute lawyers.

The provisions of Sec. 81 apply equally, with one exception, to the publication of an abridged prospectus, which is dealt with later in this chapter.

(b) INFORMATION TO BE DISCLOSED UNDER SEC. 81. Sec. 81 of the Act provides for the disclosure in every prospectus issued to the public, in the aforementioned circumstances, of the following information—

(1) *Memorandum of Association.* The full text of the Memorandum of Association, including the Association Clause, but not including the signatures of witnesses.

The Memorandum is usually printed in very small type in the fold of the prospectus.

This information need not be given in an abridged prospectus advertised in newspapers, nor in any prospectus issued more than one year after the company is entitled to commence business.

(2) *Founders' Shares.* The number of founders' or management or deferred shares (if any), and the nature and extent of the interest of the holders in the property and profits of the company.

(3) *Qualification Shares.* Particulars of qualification shares required to be held by a director. In the case of an issue of debentures, any debenture or debenture stock qualification need not be mentioned.

From this information the intending applicant will be enabled to judge the extent of the directors' faith in the concern.

Where, however, the directors or their friends take a

substantial number of shares in the company it is usual to make a special feature of this fact in the prospectus, apart from the statement as to any qualification shares. The terms upon which the directors or their friends take such shares should, however, be carefully noted, for they may differ from the terms of the public issue.

A statement as to qualification shares is not, however, required in any prospectus issued more than one year after the company is entitled to commence business.

(4) *Remuneration of Directors.* Any provisions in the Articles as to remuneration of directors, except in the case of any prospectus issued more than one year after the company is entitled to commence business, when the information need not be given.

(5) *Directors.* Full particulars of the directors or proposed directors including names, addresses, and descriptions, except in the case of any prospectus issued more than one year after the company is entitled to commence business, but even in this case the information is always given voluntarily.

The provisions of Sec. 72 of the Act must, however, be complied with before entering the name of any person, as director or proposed director, in any prospectus. This section provides that no person shall be named as a director or proposed director of a company in any prospectus issued, or in any statement in lieu of prospectus filed, by or on behalf of a company, unless, before the publication of the prospectus or filing of the statement in lieu of prospectus, as the case may be, he has by himself, or by his agent authorized in writing—

(i) Signed and filed with the Registrar of Companies a consent in writing to act as such director ; and

(ii) Either signed the Memorandum for a number of

shares not less than his qualification (if any) or signed and filed with the Registrar a contract in writing to take from the company and pay for his qualification shares (if any).

These provisions do not, however, apply to a prospectus issued after the expiration of one year from the date the company is entitled to commence business.

Sec. 72 prevents the names of persons being used as directors, with the object of attracting the investors' capital, without the knowledge and consent of the persons concerned.

Sometimes, however, where directors are unwilling to accept any responsibility for the issue of the prospectus, but are willing to join the board after allotment, a note is made beneath the names of the directors on the prospectus to the effect that "Mr. So and So will join the Board after allotment." The object of this statement is to have the benefit of such proposed director's name without involving him in any responsibility for statements made in the prospectus. The provisions of Sec. 72 would, however, apply to such director.

A knowledge of the standing of the directors, auditors, and brokers to the company is always helpful to an investor, for no person of standing would lend his name to a prospectus unless he had absolute faith in the concern. The directors' names may, therefore, all other things being equal, make or mar a prospectus.

(6) *Minimum Subscription.* The minimum subscription upon which the directors may proceed to allotment, and the amount payable upon application and allotment.

The minimum subscription is dealt with on page 239.

(7) *Previous Allotment.* In the case of a second or subsequent offer of shares, the amount offered for subscription on each previous allotment made within

the two preceding years, and the amount actually allotted, and the amount paid on the shares so allotted must be stated.

(8) *Fully or Partly paid Shares or Debentures.* The number and amount of shares and debentures which within the two preceding years have been issued, or agreed to be issued, as fully or partly paid up otherwise than in cash, and in the latter case the extent to which they are so paid up, and in either case the consideration for which those shares or debentures have been issued or are proposed or intended to be issued.

It is apparently unnecessary to state details of the consideration, provided the general nature of the consideration for the issue of the fully or partly paid shares is indicated.

The procedure on the allotment of fully or partly paid shares for a consideration other than cash is dealt with on page 244.

(9) *Vendors.* Particulars of the vendors of any property purchased or acquired by the company, or proposed to be purchased or acquired, which is to be paid for in whole or in part out of the proceeds of the issue offered for subscription by the prospectus, or the purchase or acquisition of which has not been completed at the date of the issue of the prospectus, and the amount payable in cash, shares, or debentures to the vendor, and where there is more than one vendor or the company is a sub-purchaser, the amount so payable to each vendor.

Any members of firms, which are vendors, are not to be treated as separate vendors for this purpose.

The term "vendor" is defined by sub-sections 2 and 3 of Sec. 81, which provide—

Sub-section 2. For the purpose of this section every person shall be deemed to be a vendor who has entered into any contract, absolute or conditional, for the sale or purchase,

or for any option of purchase, of any property to be acquired by the company, in any case where—

(a) the purchase money is not fully paid at the date of issue of the prospectus ; or

(b) the purchase money is to be paid or satisfied wholly or in part out of the proceeds of the issue offered for subscription by the prospectus ; or

(c) the contract depends for its validity or fulfilment on the result of that issue.

Sub-section 3. Where any of the property to be acquired by the company is to be taken on lease, this section shall apply as if the expression "purchase money" included the consideration for the lease, and the expression "sub-purchaser" included a sub-lessee.

(10) *Purchase Consideration.* The amount paid or payable as purchase money in cash, shares, or debentures, for any such property as aforesaid, specifying the amount, if any, payable for goodwill.

Any part of the purchase consideration payable in respect of goodwill must, therefore, be separately stated in the prospectus.

Goodwill is an intangible asset, and may or may not be worth the value placed upon it. It usually represents the difference between the purchase consideration and the value placed upon the net assets, and it will depend upon the profits record of the concerns purchased whether or not any value really attaches to such item.

It is a very strong point to be able to state in the prospectus that nothing is included in the valuation of the assets for goodwill where there is a value attaching to the same ; for this reason such statement will be found, as a rule, printed in bold type : on the other hand, the investor must be careful not to be misled by such a statement where, in fact, no value attaches to goodwill.

The amount payable for goodwill should also be separately stated in the contract of purchase, otherwise difficulty may arise when the apportionment of the

purchase consideration has to be made in fixing the value of the same for prospectus purposes.

(11) *Commissions.* The amount paid or payable within the two preceding years as commission for subscribing or agreeing to subscribe, or procuring or agreeing to procure subscriptions, for any shares in, or debentures of, the company, or the rate of any such commission.

It is not, however, necessary to state the commission payable to sub-underwriters.

The date or parties to the underwriting contracts need not, apparently, be stated in the prospectus, as would be the case if they came under the head of material contracts but, nevertheless, the Stock Exchange insists upon the number of shares underwritten being stated in addition to the amount or rate of commission.

The particulars of underwriting agreements entered into by directors and promoters would have to be stated separately in the prospectus as part of their interest in the promotion.

(12) *Preliminary Expenses.* The amount or estimated amount of preliminary expenses, except in the case of any prospectus issued more than one year after the company is entitled to commence business. The items comprising the preliminary expenses are set out in detail on page 24.

(13) *Promoter's Interest.* The amount paid within the two preceding years or intended to be paid to any promoter, and the consideration for any such payment.

It is important that knowledge of the interest of the promoter in the promotion should be available to the investor in order that he may assure himself whether or not the capital subscribed is to a large extent going into the pocket of the promoter, in which case it would not be available for carrying on the

business. In this connection it must, however, be remembered that promoters, as a rule, are not usually in business merely for the benefit of their health, and are entitled to some reward for their labour.

It should be noted that if the Bill dealing with the Companies (Offers for Sale) Act, 1924, reaches the Statute Book persons responsible for issues by way of an offer for sale will be treated as promoters for the purposes of this section, which is not the case at present.

(14) *Material Contracts.* Particulars of every material contract and a reasonable time and place at which they may be inspected. This provision is not to apply to a contract entered into in the ordinary course of business or to any contract entered into more than two years before the date of issue of the prospectus.

Only material contracts, which are not made in the ordinary course of business, need, therefore, be mentioned in the prospectus. A material contract has been defined as "one which might reasonably be expected to influence the judgment of a person reading the prospectus as to whether he should or should not apply for shares."

A contract is none the less material by the fact that it is an oral contract.

It is provided by Sec. 83 of the Act that a company cannot vary the terms of any contract referred to in the prospectus, or statement in lieu of prospectus, before the statutory meeting or without the approval of that meeting.

(15) *Auditors.* The names and addresses of the auditors of the company.

Where the auditors have been appointed by the directors prior to the statutory meeting, it is necessary that applicants should be in possession of this information in order that they may judge of the *bona fides* of the concern.

It is regrettable, however, that this provision does not go further and require the qualifications of the auditors to be stated, as unfortunately anyone may, at present, describe himself as an accountant and auditor, but the qualification of a Chartered or Incorporated Accountant is attained only after a period of intensive practical training and the passing of very severe tests in the examination halls.

(16) *Directors' Interests.* Full particulars of the nature and extent of the interest (if any) of every director in the promotion of, or in the property acquired by, the company, or where the interest of such a director consists in being a partner in a firm, then the nature and extent of the interest of the firm, together with a statement of all sums paid, or agreed to be paid to him or to his firm in cash or shares or otherwise, by any person either to induce him to become, or to qualify him as, a director, or otherwise for services rendered by him or by his firm in connection with the promotion or formation of the company.

This information is required in order to prevent directors making a profit out of the promotion without disclosing the extent of that profit to intending applicants.

The prospectus requires the utmost good faith to be exercised in its preparation, and from this point of view it is important that investors should have complete knowledge of the extent of the interests of the directors and promoters in the promotion and property of the company. This information will usually be found printed in very small type in the body of the prospectus.

Directors' interests need not, however, be stated in any prospectus issued more than one year after the company is entitled to commence business.

(17) *Voting Rights.* The voting rights of the holders



of different classes of shares where the capital of the company is divided into shares of different classes.

This information will enable intending applicants to ascertain which class of share carries the controlling interest in the company.

The controlling interest must not be assumed from the nominal value of the shares of any particular class, for it sometimes happens that the holder of a share with 1s. nominal value may have voting rights equal to, or even greater than, the holder of a share with a nominal value of £1 or even £5.

(c) **WAIVER OF PROVISIONS OF SEC. 81.** The aforementioned provisions of Sec. 81 cannot be waived by applicants for shares or debentures, for sub-section 4 of that section provides that any condition requiring or binding any such applicants to waive compliance with the requirements of Sec. 81, or purporting to affect him with notice of any contract, document, or matter not specifically referred to in the prospectus, shall be void.

The applicants must therefore have actual notice of the matters to be disclosed. Constructive notice is not sufficient, and it is not enough that such applicant is put upon inquiry by any statement in the prospectus. There must be a full and frank disclosure.

(d) **EFFECT OF NON-COMPLIANCE WITH SEC. 81.** A person induced to take shares or debentures on the strength of a prospectus which fails to make the disclosures required by Sec. 81 has no right of rescission of the contract to take the shares against the company, nor has he any remedy whatsoever against the company.

There is no penalty laid down for non-compliance with the section, but it is provided in sub-section 9 that "nothing in this section shall limit or diminish any liability which any person may incur under the general law or the Act apart from this section." The

remedy of the applicant would therefore be to bring an action for damages against the promoters, directors, or any other persons who may be responsible for the issue of the prospectus containing the omission.

The applicant would not have to prove fraud, for this is implied, but he would have to satisfy the Court—

(1) That the person or persons against whom the action is brought issued or authorized the issue of the prospectus.

(2) That there was non-disclosure of information required to be disclosed by Sec. 81.

(3) That such non-disclosure was material: what is or is not material will depend upon the facts of the case.

(4) That he took shares on the strength of the prospectus not making the disclosures; that is to say, that had he known of the non-disclosed matters he would not or might not have taken the shares.

(5) That he had no knowledge of the non-disclosed particulars within a reasonable time before allotment, and consequently had not available to him the remedy of withdrawing his application.

(6) That he suffered damage.

Sub-section 6 of Sec. 81, however, provides that a director or other person responsible for the prospectus is not to incur any liability by reason of non-compliance with the terms of that section, if he proves—

(i) As regards any matter not disclosed, that he was not cognisant thereof; or

(ii) The non-compliance arose from an honest mistake of fact on his part.

It will be observed that the onus of proof of these matters is on the director or other person sued.

In the case of non-disclosure of the interests of any director in the promotion or property of the company, the onus of proving that the director had knowledge

of the matters not disclosed is upon the person bringing the action, and unless this is proved the director has no liability.

It should also be noted that the remedy of an applicant in the case of non-disclosure under Sec. 81 differs from the remedies available to him under Sec. 84 in the case of misrepresentation, which are dealt with later.

(e) OTHER INFORMATION IN PROSPECTUS. A prospectus which confines itself to making the disclosures required under the Act would not give much information as to the business itself, consequently absolute freedom is given to the promoter or other person issuing the prospectus as to what further information they shall give the public, but there must be no fraud or misrepresentation, and the persons responsible must not only believe the information they give to be true, but must have reasonable grounds for so believing.

The further information given usually includes the following—

(1) A statement that a copy of the prospectus has been filed with the Registrar of Companies. This information is compulsory under the Act.

(2) A statement that application is to be made to the Stock Exchange for an official quotation. It is an advantage to have the securities quoted in the Official List issued daily by the Stock Exchange, as such a quotation strengthens the market in them. The Stock Exchange requires to be perfectly satisfied as to the genuineness of the concern before it will allow the shares or debentures to be quoted officially.

The requirements of the Stock Exchange to be complied with before permission is given to deal in the shares, and before it will allow an official quotation, are dealt with in Chapter XIII.

(3) A statement of the Authorized Capital, Capital

already issued (if any), and the class of shares comprising the same, together with particulars of any Loanable Capital issued.

(4) The price and terms of the present issue of shares or debentures.

Shares can be issued only at par or at a premium. They cannot be issued at a discount as this is illegal. The effect of the payment of commissions, in this respect, has, however, already been dealt with.

Debentures, Debenture Stock, or Notes may be issued at par, or at a discount, or at a premium.

The terms of the issue may require payment of a small amount, not less than 5 per cent of the total nominal value of the shares, on application, and the balance on allotment, or fixed amounts may be payable upon application and allotment, the remaining balance being payable in one or more instalments on dates fixed by the prospectus, or may be left to be called up as and when the directors think expedient.

Any premium is usually payable either on application or on allotment.

The price per share fixed will be based upon the value of the net assets. This will vary according as to whether the shares offered are preference or ordinary shares.

The value per share of the preference shares in net assets will be found by dividing the total value of the assets, less creditors and loanable capital, by the total number of preference shares.

The value of the ordinary shares will be based on the total value of the assets, less creditors, loanable capital, and preference share capital; the value per ordinary share being found by dividing the resulting figure by the total number of ordinary shares.

Where the preference shares have no preference

as to capital, the net assets, less loanable capital, must be divided by the total number of preference and ordinary shares to find the value per share of both classes.

When the value of the shares in net assets has been ascertained it will usually be necessary to adjust it as to yield, in accordance with the considerations set out on page 51, before fixing the issue price.

(5) Dates dividends are payable. The attractiveness of the issue will be increased by fixing in the prospectus the dates upon which interim and final dividends are payable. The directors will then either have to pay the dividends on the due dates, or give reasons, by circular or other method, for the passing of the same, otherwise the secretary's office will be swamped with correspondence from shareholders on the matter.

The first dividend is, as a rule, calculated from the due dates of allotment and instalments.

(6) Expert reports or extracts therefrom. These reports may be printed in the prospectus in full or extracts only printed as may be decided by the responsible parties.

Any statements made purporting to be made on the strength of expert reports must be substantially correct if the persons issuing the prospectus are to avoid responsibility for any untrue statement they may contain.

The responsible parties to the issue will also have personal liability in so far as they may adopt the statements of the experts and make them their own.

The accountant's report is always given in full. This report also sometimes incorporates the valuations made by the valuers, and includes a statement of the amount of working capital that will be available if the issue is fully subscribed.

Expert Reports are fully dealt with in Chapter III.

(7) Qualification of Managers. The qualifications of the managers are usually enlarged upon in the prospectus, and a statement made as to whether any concerns taken over are to continue to have the benefit of the services of the managers. The continuity of management is an important point in a prospectus.

(8) As to the nature of the company's products and future prospects of the company. The statements contained in the prospectus with regard to these matters are usually, to put it mildly, optimistic. Allowance should therefore be made, when reading them, for such optimism and also for a little exaggeration. It should be remembered that the promoters, in drafting the prospectus, usually suffer from the great weakness, experienced by all persons who have anything to sell, of making the utmost of their wares, even to the extent of playing upon the credulity of the investor, e.g. by the sale of shares in plots of land under one thousand miles from an oil bearing well, or shares in a company formed for the purpose of extracting gold from the sun's rays. The main and dominant object of the issue of the prospectus is, of course, to sell the shares or debentures offered.

Over-emphasis of the virtues of the business may spoil what might otherwise be a good prospectus, as the investor is often inclined to remember, when reading such statements, that old nursery rhyme, "Come into my parlour said the spider to the fly," and in consequence avoids an intended purchase.

The persons responsible for the issue of the prospectus must not, however, allow their natural optimism to carry them so far as to make untrue statements, or statements they have no reasonable ground for believing to be true, if they wish to avoid liability for misrepresentation.

(f) MISREPRESENTATION IN PROSPECTUS. It has already been indicated that the object of the promoter is to make the prospectus as attractive as possible to the investor, but in doing so he must remember that the utmost good faith must be exercised by him, and that if any untrue statements are made with his knowledge he will have to stand the consequences.

All facts must be disclosed which are material, that is to say, which are likely to influence the judgment of the intending applicant in arriving at his decision whether or not to apply for the shares or debentures offered.

Non-disclosure of facts, as distinct from a misstatement, will not of itself, however, render the persons responsible for the issue of the prospectus liable, unless such suppression of fact gives a false position to the prospectus as a whole.

The prospectus may contain statements which at the time of issue are perfectly true, but which for some reason or other may become untrue before allotment, and should, in consequence, be brought to the knowledge of the applicants before allotment is proceeded with.

Persons subscribing for shares on the strength of statements which they afterwards discover to be untrue, have one of the following remedies—

I. To bring an ordinary action for deceit. In this case the plaintiff would have to prove—

(1) That there was a misstatement of material fact.

(2) That it was made by the person sued or under his authority.

(3) That it was wilfully made with intent to deceive.

(4) That he was deceived.

(5) That he suffered damage.

II. To bring an action under Sec 84 of the Act,

which incorporates the provisions of the Directors Liability Act, 1890—

(i) Against the company for rescission of the contract and

(ii) Against the persons responsible for the issue of the prospectus for damages.

In this case the plaintiff would have to prove only—

(1) That the person sued made or authorized the misstatement in the prospectus.

(2) That it was a misstatement of a material fact.

(3) That he was deceived and induced by the misrepresentation to apply for shares.

(4) That he suffered damage.

He does not in this case have to prove any intent to deceive on the part of the persons making or authorizing the statement, and the persons sued will be liable unless they can prove that they believed the statement to be true, and further that they had reasonable ground for so believing. In an action for deceit, however, it is sufficient for the defendant to prove that he believed the statement to be true even if the grounds for so believing are unreasonable.

The measure of damages will be the difference between the value of shares in a company having the advantages stated in the prospectus, and the value of shares in a company without these advantages, the difference being ascertained on the day after allotment.

The persons injured by the misrepresentation will lose their right to rescission against the company in the following cases—

(1) If there is any undue delay on their part to take action. Even a small delay may prove fatal.

Time does not begin to run, however, in this connection, until the misstatement has been brought to the knowledge of the applicant. The applicant must



therefore take action as soon as he has knowledge of the misrepresentation.

(2) If the company goes into liquidation before the applicants have exercised their right to repudiate, the contract being voidable, not void; on the winding-up of the company the rights of third parties, namely the creditors, will have intervened to prevent the contract being rescinded.

It is therefore essential that no time be lost in taking action, but where the right to rescission against the company has been lost by negligence or otherwise, this will not affect the remaining right to sue the persons responsible for the issue for damages, which right remains even after liquidation has commenced.

The right to rescission of the contract may also be lost by the consent of the applicant after he has knowledge of any untrue statement, e.g. if he endeavours to sell his shares, pays calls, receives dividends or votes at meetings, all of which actions will be taken as ratifying the contract.

Upon the rescission of the contract becoming effective the applicant is entitled to have all moneys paid by him returned with interest at the rate of 4 per cent per annum to the time of repayment.

Only persons who have subscribed for shares direct from the company on the strength of misstatements in a prospectus, or in a statement in lieu of prospectus, have the right of rescission or the right to sue for compensation.

The estate of a person who was liable under Sec. 84 before death, will not be liable unless it has benefited by the fraud, and a director who has paid compensation to applicants injured by misrepresentation in a prospectus has apparently no right of contribution from the estate of a deceased co-director equally liable. He may, however, under Sec. 84 (4) recover from

others equally responsible with himself and who are living.

In order successfully to defeat an action for compensation under Sec. 84 the persons sued must prove—

(i) With respect to every untrue statement not purporting to be made on the authority of an expert or of a public or official document or statement, that he had reasonable ground to believe, and did, in fact, believe up to the time of allotment that the statement was true ; and

(ii) With respect to any untrue statement purporting to be a statement by, or a copy of, or an extract from, a report or valuation of an expert, that it fairly represented the statement or was a correct and fair copy of, or extract from such reports or valuations. Provided (and this proviso is most important), that the persons responsible for the issue of the prospectus shall be liable if it be proved that they had no reasonable ground to believe that the person making the statement, report, or valuation was competent to make it ; and

(iii) With respect to every untrue statement purporting to be a statement made by an official person or contained in what purports to be a copy of, or extract from, a public official document that it was a correct and fair representation of the statement, or copy of, or extract from, the document.

Where these defences are not open to the defendant he may escape liability by proving the following—

(1) That having consented to become a director of the company he withdrew his consent before the issue of the prospectus, and that it was issued without his authority or consent ; or

(2) That the prospectus was issued without his knowledge or consent, and that on becoming aware of its issue he forthwith gave reasonable public notice that it was issued without his knowledge or consent ; or

(3) That after the issue of the prospectus and before allotment thereunder, he, on becoming aware of any untrue statement therein, withdrew his consent thereto, and gave reasonable public notice of withdrawal, and of the reason therefor.

The public notice required above under (2) and (3) must be circulated as widely as the prospectus itself was circulated in order to ensure immunity from liability.

Sub-section 3 of Sec. 84 provides that directors who have authorized the issue of the prospectus shall indemnify all other persons named in the prospectus as directors, or as having agreed to become directors but who have never consented to act, against all damages, costs, and expenses to which they may be made liable by reason of their names being on the prospectus, or in defending themselves against any action or legal proceedings brought against them in respect thereof.

### **Issue of Prospectus.**

(1) DATING, SIGNING, AND FILING. Before any prospectus can be issued by or on behalf of a company, or in relation to an intended company, the following requirements of Sec. 80 of the Act must be observed—

(a) The prospectus must be dated, such date being *prima facie* evidence as to the date of its publication.

(b) It must be signed by every person named therein as a director or a proposed director of the company or by his agent duly authorized in writing. The object of this provision is to fix the responsibility for the contents of the prospectus.

(c) It must be filed for registration with the registrar of companies on or before the date of its publication, and no prospectus must be issued to the public until a copy has been so filed.

(d) Every prospectus must state on the face of it that a copy has been filed as required in the preceding clause.

Non-compliance with these provisions as to filing the prospectus renders the company, and every person knowingly a party to the default, liable to a fine not exceeding five pounds for every day from the date of the issue until a copy is so filed.

(2) ARRANGEMENTS FOR ADVERTISING AND DESPATCHING COPIES OF PROSPECTUS. Arrangements for advertising the prospectus should be made with a responsible firm of publicity agents, who will take all necessary steps for the publication of the same in the press.

In addition to newspaper advertisement it may be thought expedient to despatch copies of the prospectus, together with forms of application, to individual shareholders in other companies. There are in existence several firms who keep for this purpose more or less up-to-date registers of all persons holding shares in the most important companies and who will, for a consideration, despatch as many copies of the prospectus as the company may desire.

Judging by the many copies of the prospectus sent out in this way which are subsequently returned, care should be exercised in the choice of such agents as, to say the least of it, the evidence of the dead letter office indicates that the registers kept by some of the distributing agents are not so frequently revised as they might be.

The secretary should ascertain from the company's bankers, brokers, and others, how many copies of the prospectus they will require, and make arrangements with the printers to despatch the required number direct to the head office and branches of the bank, etc.

(3) ABRIDGED PROSPECTUS. The prospectus is

rarely advertised in newspapers in full, and in consequence the advertisement is generally styled "abridged prospectus." The persons responsible for the issue of it even go so far as to omit some of the disclosures required by Sec. 81 of the Act. Where this is done a risk is run of incurring the liabilities, already mentioned, for non-disclosure under that section, as the document advertised clearly comes within the definition of prospectus given in Sec. 285 of the Act. Further, the Act clearly shows that newspaper advertisements of the prospectus were taken into consideration when the items to be disclosed in the prospectus were settled, for by Sec. 81 (5) of the Act it is provided that where any prospectus, to which Sec. 81 relates, is published as a newspaper advertisement, it shall not be necessary in the advertisement to specify the contents of the Memorandum, or the signatories thereto, or the number of shares subscribed for by them.

The object of this sub-section is to reduce somewhat the cost of advertising by avoiding the publication of the detail contained in the Memorandum.

The fact that this sub-section thus excludes part of the provisions of the section would seem to imply that all the other information required to be disclosed in a prospectus must be given in any newspaper advertisement thereof.

An advertisement, however, which does not offer the shares or debentures for sale, but merely states the contents of the prospectus and the places where copies may be obtained, does not appear to come within Sec. 81 but, as forms of application are generally printed in the paper annexed to these newspaper advertisements upon which the public are invited to apply for shares or debentures on the strength, not of the prospectus as advertised, but of the full prospectus,

it is submitted that if there are any material differences between the two the applicant may have ground for repudiation if he has not had an opportunity of seeing the full prospectus before allotment. In order to obviate this difficulty it is advisable to send out copies of the full prospectus to all newspaper applicants immediately on receipt of the newspaper form of application, and before allotment, thus providing the applicant with the remedy of withdrawing his application if he is not satisfied with the basis upon which he has offered to take the shares or debentures.

Where possible an acknowledgment of the receipt of the full prospectus should be obtained from such applicants.

The newspaper application forms will bear an identification number indicating the paper from which the form has been obtained. It is useful, as a matter of record, to analyse such forms under the numbers given, thus securing a record of the degree of success of each advertisement.

Newspaper proprietors would render a great service to the public if they would refuse to advertise any prospectus which, on the face of it, is doubtful in character, and it is believed that this is done to a small extent. The amount of advertising given to the paper should on no account, however, be allowed to influence its editorial comments on or criticisms of the prospectus itself. On the other hand, it does seem to be inconsistent for a paper to ask the public, by advertising the prospectus, to subscribe to the issue, and at the same time to have an adverse editorial comment telling the public not to subscribe. It may, of course, be argued that the proprietors have merely sold the space for the advertisement, but it should be remembered that there is nothing advertised to which the principle of "Truth in Advertising" should be

more strictly applied than to the advertisement of a prospectus.

### **Hints on Reading the Prospectus.**

The following rules have been put down for the guidance of investors in reading a prospectus—

(a) If possible, obtain a copy of the Articles of the company or inspect the copy filed at Somerset House in order to find out the full powers of the directors, for they may possibly have power even to sell the business without consulting the shareholders.

(b) Examine carefully the copy of the Memorandum printed in the fold of the prospectus for the powers of the company.

(c) Where a newspaper advertisement is being dealt with, obtain a full copy of the prospectus and compare, noting any differences between the two.

(d) Read carefully the names of the directors, managers, stockbrokers, and auditors.

(e) Read very carefully all small print, for here will usually be found the following information—

(1) Interests of directors and promoters in the promotion.

(2) Purchase consideration and particulars of vendors and sub-vendors.

(3) The extent of the promotion profit and its nature, i.e. whether in cash or shares or both.

(4) Directors' remuneration and qualification.

(5) Underwriting and overriding commissions and brokerage payable.

(6) Rights of shareholders to attend meetings and their voting powers.

(7) Particulars of material contracts and estimate of preliminary expenses.

(f) Examine the accountant's report. In doing so—

(1) Ignore averages and percentages.

(2) Ascertain whether profits and turnover have consistently increased over the period given or whether they have decreased, in which latter case a declining business will be revealed.

(3) Consider the items shown as having been excluded in arriving at the stated profits.

(4) Ascertain working capital available for carrying on the business.

(5) See if the valuation of assets includes anything for goodwill, and compare such value, if any, with the average of the last three years' profits given in the accountant's report, and the total value of the assets.

(6) Note the nature of any liabilities taken over under the purchase agreement.

(7) Carefully note the wording of the report, and see that it is signed by an accountant with a recognized qualification, e.g. Chartered Accountant or Incorporated Accountant.

(g) Carefully read the valuers' reports, if any, paying particular attention to their remarks as to the earning capacity of the plant, etc., as well as to its value.

(h) Ascertain dividend records of the concerns to be purchased, or in the case of an issue by an established company, of that concern.

(i) In the case of a share issue see whether there are any mortgage debentures, and note the differences in the rights of the holders of different classes of shares.

(j) Read the bold print. This will usually consist of the hopes, beliefs, and aspirations of the persons responsible for the issue, and in consequence allowance should be made for possible optimism and exaggeration.

## STATEMENT IN LIEU OF PROSPECTUS

A public company which does not issue a prospectus



on or with reference to its formation is precluded, by Sec. 82 of the Act, from allotting any shares or debentures unless, before the first allotment of either shares or debentures, it has filed with the Registrar of Companies a Statement in Lieu of Prospectus.

The matters which must be included in such statement are slightly different from those which have to be given in a prospectus in the following instances—

The Statement in Lieu of Prospectus need not include—

(1) The contents of the Memorandum, although it must include particulars of the nominal capital and the shares into which it is divided.

(2) Particulars of founders' or deferred shares.

(3) The qualification and remuneration of directors.

(4) The voting rights of the different classes of shareholders.

The Statement in Lieu of Prospectus must state any provisions precluding holders of shares or debentures from receiving and inspecting balance sheets or reports of the auditors or other reports, which information is not required to be stated in a prospectus.

The Statement in Lieu of Prospectus must be signed in the same manner as a prospectus, that is to say, by every person named therein as a director or proposed director, or by his agent authorized in writing.

The form and contents of the Statement in Lieu of Prospectus are set out in the second schedule to the Act, and are given on the opposite page.

The signatories of a Statement in Lieu of Prospectus have similar liabilities in respect of any untrue statements it may contain, irregular allotments, etc., as the persons are under who are responsible for the issue of a prospectus. These liabilities are dealt with fully in their proper places in this book.

## THE COMPANIES (CONSOLIDATION) ACT, 1908.

## THE PUBLIC COMPANY LIMITED

## STATEMENT IN LIEU OF PROSPECTUS

The nominal share capital of the company	£
Divided into . . . . .	Shares of £..... each " " " " " "
Names, descriptions, and addresses of directors or proposed directors	
Minimum subscription (if any) fixed by the memorandum or articles of association on which the company may proceed to allotment	
Number and amount of shares and debentures agreed to be issued as fully or partly paid up otherwise than in cash. The consideration for the intended issue of those shares and debentures.	1. ....shares of £.. .... fully paid. 2. . . . .shares upon which £ per share credited as paid. 3. .... debenture . . . . £ 4. Consideration.
Names and addresses of (a) vendors of property purchased or acquired or (b) proposed to be purchased or acquired by the company. Amount (in cash, shares, or debentures) payable to each separate vendor.	
Amount (if any) paid or payable (in cash or shares or debentures) for any such property, specifying amount (if any) paid or payable for goodwill.	Total purchase price £ Cash . . . £ Shares . . . £ Debentures . . . £  Goodwill . . . £

STATEMENT IN LIEU OF PROSPECTUS (*contd.*).

Amount (if any) paid or payable as commission for subscribing or agreeing to subscribe or procuring or agreeing to procure subscriptions for any shares or debentures in the company, or	Amount paid.
Rate of the commission . . .	„ payable.
Estimated amount of preliminary expenses	Rate per cent.
Amount paid or intended to be paid to any promoter.	£
Consideration for the payment.	Name of promoter.
Dates of, and parties to, every material contract (other than contracts entered into in the ordinary course of the business intended to be carried on by the company or entered into more than two years before the filing of this statement).	Amount £
Time and place at which the contracts or copies thereof may be inspected.	Consideration—
Names and addresses of the auditors of the company (if any).	
Full particulars of the nature and extent of the interest of every director in the promotion of or in the property proposed to be acquired by the company, or, where the interest of such a director consists in being a partner in a firm, the nature and extent of the interest of the firm, with a statement of all sums paid or agreed to be paid to him or to the firm in cash or shares, or otherwise, by any person	

STATEMENT IN LIEU OF PROSPECTUS (*contd.*).

either to induce him to become, or to qualify him as, a director, or otherwise for services rendered by him or by the firm in connection with the promotion or formation of the company.	
Whether the articles contain any provisions precluding holders of shares or debentures receiving and inspecting balance sheets or reports of the auditors or other reports.	Nature of the provisions.

(Signatures of the persons above-named  
as directors or proposed directors, or of  
their agents authorized in writing) . . . . .

A private company is not required to file a Statement in Lieu of Prospectus, but if it pays any commission on placing shares it must file a statement containing particulars of the same.

## APPLICATION AND ALLOTMENT

The Secretary should now instruct the bankers to open separate accounts for application, allotment and instalments (if any), and make arrangements with them for the periodical collection of application forms and bankers' statements. A copy of the application and allotment letters should also be placed in their possession for reference. Where there are different classes of shares separate banking accounts should be opened for each class.

The law of contract applies equally to an application for and allotment of shares or debentures as to any other contract. It is necessary, therefore, to remember the following elementary principles of contract law—

(a) There must be an offer and acceptance.

(b) The acceptance must be made in the same terms as the offer, that is to say, the acceptance of the offer must be unconditional.

(c) There must be no unreasonable delay in signifying acceptance.

(d) The acceptance must be communicated to the offeror, but this may be waived at his request.

(e) An offer may be revoked at any time before acceptance.

(f) The revocation of an offer must be communicated to the offeree.

In addition to these principles it must also be remembered that any special regulations of the company with regard to the form of, or procedure relating to, the application for or allotment of shares or debentures must be adhered to.

### **Application.**

(a) NATURE OF APPLICATION. The application for shares or debentures is usually an offer made to the company to take them, but where an issue of shares is made as of right to existing share or debenture holders, the posting of the application letter by the applicant may be the acceptance of an offer made by the company, e.g. where a right is given by the company to shareholders to take up a further limited number of shares in proportion to their present holding.

The publication of a prospectus is not, therefore, an offer made by the company to the public to allot shares or debentures to all applicants. It is merely an invitation to the public, inviting them to make the company an offer on the terms laid down in the prospectus.

The application, being thus an offer, may be revoked at any time before its acceptance has been communicated, but it will be seen later that the acceptance

of the offer may have been properly communicated although knowledge of its acceptance may never reach the applicant. On the other hand, the withdrawal of the application to be effective must be brought to the knowledge of the company and must reach it before the shares or debentures have been allotted. Therefore, if a letter of revocation, that is to say, the withdrawal of the application, is posted, it is ineffective if it gets lost in the post and never reaches the company, or if it is delayed in the post and reaches the company after allotment has been made.

An application to take shares may be conditional, e.g. on condition that the applicant be appointed to hold some office in the company.

(b) FORM OF APPLICATION. Companies generally require a form of application, which is always enclosed with the prospectus, to be filled in, and care should be taken to observe the directions given for filling it in, e.g. by writing the name in block letters. Much valuable time is lost, in the rush period entailed by a public issue of capital, in having to decipher names, write to applicants for their full christian names, where initials only are given, and by having to obtain information as to the occupations of the applicants.

Where the Articles do not make a written application essential there is nothing to prevent an oral application being made, in which case the acceptance of the application could also be made orally. This procedure might, however, lead to subsequent disputes, and would certainly increase the work of the staff dealing with the issue, for which reasons it should never be allowed. The application form should be signed by the applicant, or by his agent duly authorized. Where application forms are signed by an agent, the authority of the agent should be enquired into.

The following is the usual form of application where

no receipt is given by the company in respect of application moneys—

*Application for Shares.*

*No...* . . . . .

THE PUBLIC COMPANY LIMITED  
ISSUE OF

300,000 7 per cent Cumulative Preference Shares of £1 each at par,  
and 400,000 Ordinary Shares of £1 each at 21s. 6d. per share.

FORM OF APPLICATION FOR SHARES

*To the Directors,*

THE PUBLIC COMPANY LIMITED.

Gentlemen,

Having paid to your bankers the sum of £. .... being a  
Deposit of 2s. 6d. per Share on Application for ... Preference  
..... Ordinary

Shares of £1 each at par

Shares of £1 each, at 21s. 6d. per share

of the above company, I request you to allot me shares in accordance with such application upon the terms of the company's Prospectus dated . . . . ., and of the Memorandum and Articles of Association of the company, and I hereby agree to accept the same or any smaller number that may be allotted to me, and to pay the balance due from me by the instalments specified in the said Prospectus, and I authorize you to place my name on the register of members of the company as the holder of the shares allotted to me.

Dated this . . . . . 192..

Please write distinctly	{	Usual Signature .....
		Name in full (BLOCK LETTERS) .....
		(State if Mr., Mrs., or Miss)
		Address (in full) .....
		Occupation .. .. .

Cheques should be drawn payable to "Bearer," and crossed "Not Negotiable."

Any alteration from "Order" to "Bearer" must be authenticated by the Drawer's signature.

No receipt will be issued for payment on application, but an acknowledgment will be forwarded in due course, either by letter of allotment in whole or in part or by return of deposit.

This Form of Application should be sent to . . . . . or to  
..... or any of its branches, with a remittance for the amount payable on application.

(c) METHOD OF DEALING WITH APPLICATIONS. The following has been found in practice to be a good method of dealing with applications—

(1) Number the forms immediately they are received

from the bankers. Where more than one class of share is issued give a distinctive letter before the number, and number each class separately.

(2) Check bankers' statements with the application forms, noting all underpayments.

(3) Enter from the forms full particulars of the applications on the application and allotment sheets in numerical order, and write up shareholders cash book from bankers' statements.

(4) Bring underpayments to the notice of the applicants concerned.

(5) Enter particulars of applications bearing the marks of brokers and other authorized agents on the Brokerage List, which should be ruled as follows—

BROKERAGE LIST

No. of Applcn.	Name of Applicant.	Name of Broker	Name of Broker	Name of Broker
		No. of Shares.	No. of Shares.	No. of Shares.

No applications should be entered on this list which are marked with an underwriter's stamp, and which are intended to be applied in relief of his personal underwriting, but particulars of such should be entered on an underwriting list ruled similarly.

Brokerage is, as a rule, payable only upon the number of shares actually allotted, so that if any shares entered on the list are not subsequently allotted, they must be struck off the list.

(6) Send out copies of the full prospectus to all



applicants applying on newspaper forms, where an abridged prospectus has been advertised.

(7) File the application forms in numerical order.

### **Allotment.**

There is no binding contract until allotment has been made, and notice of it has reached the allottee either directly or through his agent.

(a) NATURE OF ALLOTMENT. Allotment is the acceptance of the offer to take shares or debentures, and to be effective must be communicated to the applicant by post or brought to his knowledge by some other medium.

The post office in this case is regarded as the agent of the applicant, therefore delivery of the Letter of Allotment to the agent is sufficient notice to the principal, consequently the contract is complete as soon as the Letter of Allotment is posted. It does not matter if the applicant never receives the letter owing to its loss in the post, or if the letter is delayed in the post, he will have lost his right to withdraw his application, as an offer cannot be withdrawn without the consent of the other party, once it has been properly accepted. The posting must, however, be done in a regular manner, and it is not sufficient to hand the Allotment Letter to a postman in the street.

The company should be careful to keep proof as to time and place of posting Allotment Letters in case of subsequent dispute, as the onus of proof will be on the company.

The allotment will also be good if it be brought to the notice of the applicant in any other manner before the applicant withdraws his application. It is, however, thought that if the offer to take shares, etc., is made in writing, it should be accepted in writing, as is the rule in any other contract.

Notice of allotment is unnecessary, however, if the applicant has expressly waived the notice. Also where shares are to be allotted as of right to existing shareholders the contract is complete as soon as the application form is posted.

Unreasonable delay in going to allotment will cause the offer to lapse.

The offer to take shares is usually worded as an agreement to take a specified number of shares, or such less number as the company may decide. This is a necessary provision for over-subscription, otherwise the company would have to allot all or none of the shares applied for, or obtain fresh applications from each applicant for the exact number of shares it is intended to allot.

Allotment must be made by a duly constituted board of directors, but where the board is not duly constituted relief may be given under the rule in *Royal British Bank v. Turquand* previously referred to in this book. (See page 121.)

An allotment which disregards any condition attaching to the application may be repudiated by the allottee.

The Court may order specific performance of a contract to take shares or to allot shares, but if all the shares have already been allotted the only remedy is in an action for damages.

No allotment can be made until the provisions of Sec. 85 of the Act have been complied with as to minimum subscription. These are dealt with on page 239.

Allotment will be in the form of a resolution of the directors, and should be recorded on the minutes. The chairman will sign and date the application and allotment sheets up to the point of allotment.

Allotment does not make the allottee a member.

Entry in the Register of Members is necessary for this, except in the case of signatories to the Memorandum.

(b) FORM OF ALLOTMENT. Allotment may be communicated orally where the application was made orally, but as such a course usually leads to subsequent trouble, allotment is nearly always communicated in writing by what is termed an "Allotment Letter."

Allotment Letters in respect of amounts under £5 must be stamped with a 1d. stamp, and if over £5 then with a 6d. stamp.

Badly drafted Allotment Letters will cause considerable trouble not only to the secretarial staff dealing with them, but to the bankers.

The following form of Allotment Letter is recommended, as it is found to be convenient in practice—

THE PUBLIC COMPANY LIMITED

*Stamp.*

ISSUE OF

300,000 7 per cent Cumulative Preference Shares of £1 each at par,  
and 400,000 Ordinary Shares of £1 each at 21s. 6d. per share.

No. ....

Dividend House, Golden Street, E.C.2.

....., 192..

To .....

Sir (or Madam),

I am instructed by the Directors to inform you that in accordance with your application they have this day allotted you.....  
Ordinary Shares of £1 each at 21s. 6d. per Share in the above-named company (numbered..... to..... inclusive).

The total amount payable thereon upon applica-

tion and allotment (viz., ..... per share), is £

You have paid on application . . . . £

Making amount due from you on allotment . £

or making amount due to you for which a cheque  
is enclosed . . . . . £

Payment of the amount due should be made forthwith as directed below.

The remaining instalment of ..... per share must be paid as



cent of the nominal amount of the shares, has been received in cash by the company. In England, for allotment to be good, cheques must be actually cleared before allotment is made, but in Scotland the allotment will be good if made before the cheques are cleared, provided they are subsequently honoured.

The amount so fixed as the minimum subscription must be reckoned exclusively of any amount payable otherwise than in cash.

These restrictions which, with the exception of the amount payable upon application, apply only to a first allotment of shares offered to the public for subscription, cannot be waived. If the provisions of Sec. 85 are not complied with within forty days after the issue of the prospectus, all application moneys must be returned. If the money is not so returned within a further eight days the directors of the company will be jointly and severally liable to repay that money with interest at 5 per cent per annum from the expiration of the forty-eighth day.

The object of Sec. 85 is to prevent persons from attempting to carry on the business with insufficient working capital, but this object is defeated by the fact that so many new companies fix their minimum subscription at seven shares, the minimum number required to be held by the signatories to the Memorandum. The benefit of the section is thus lost, as the Companies Acts do not, unfortunately, specify any fixed amount as the minimum subscription, except where the Articles of the company make no provision for the same, in which case the whole amount offered to the public is the minimum subscription.

(d) IRREGULAR ALLOTMENT. Sec. 86 of the Act provides that an allotment made in contravention of the aforementioned provisions of Sec. 85 relating to minimum subscription, shall be voidable at the option

of the allottee within one month of the holding of the statutory meeting, but not later. Unlike the remedy under Sec. 84 for misrepresentation, this section specially provides that the option given to the allottee to repudiate the allotment may be exercised even though the company is in liquidation, provided it is exercised within one month of the statutory meeting.

Directors who knowingly contravene the provisions of Sec. 85, or permit its contravention with respect to allotment, have a twofold liability, for they are liable—

(1) To compensate the company for any loss, damages, or costs it may have sustained or incurred thereby; and

(2) To compensate likewise the allottees.

Proceedings to recover such damages from the directors cannot, however, be commenced after the expiration of two years from the date of allotment.

The allottee, therefore, loses his right against the company to repudiate the irregular allotment unless he does so before the expiration of one month from the date of the holding of the statutory meeting, and both the allottee and the company will lose their right to damages against the directors unless they commence proceedings before the expiration of two years from the date of allotment.

(e) OVER-SUBSCRIPTION AND ALLOTMENT. If the issue is over-subscribed the directors may decide to close the list before the date fixed by the prospectus for closing it, in which case they will proceed to allotment forthwith. Country applications are, however, usually given consideration up to a day later than town applications.

Where there is an over-subscription the directors should, if they wish to avoid giving offence to applicants, allot on some well defined basis, e.g. they may decide upon one of the following methods—

(1) To give preference to customers.

(2) To allot in the order the applications were received.

(3) To allot to all the applicants in proportion to their applications in order to avoid returning application moneys and sending out letters of regret.

(4) Where the issue is not a first issue preference may be given to existing shareholders or to a particular class of shareholder.

Over-subscription is sometimes effected artificially by obtaining firm applications from the underwriters, before the list is closed, for shares covering their full liability on the under-subscription, thus making the list over-subscribed, not by public subscriptions but by underwriters' subscriptions.

The effect of this transaction will probably be to keep the price of the shares or securities round about par or even at a premium, instead of falling to a discount, as would certainly have been the case had the knowledge of the actual state of affairs been made public property. The underwriters will then form a pool of their shares or securities, and dispose of their holdings to the public in satisfaction of the demand created by the public advertisement of over-subscription.

Before proceeding to allotment the directors may attempt the difficult task of hunting down the stags, that is to say, those applicants who have applied with the object of getting out at a small profit immediately after allotment. There are directors who profess themselves to be proficient in this elimination, but there is no doubt that it is a difficult problem which, of course, arises only on an over-subscription, and no attempt will be made with this hunt if the issue is under-subscribed.

The object of getting rid of the stags is to prevent a heavy fall in the shares consequent on heavy selling by such persons, where there are many of them.

Letters of Regret should be sent to any disappointed applicants, and the usual form of these is as follows—

THE PUBLIC COMPANY LIMITED

.....  
..... 19..

Sir,

Referring to your application for shares in this company, I regret to say that, owing to the over-subscription of the same, the Directors have been unable to make you any allotment. I therefore beg to forward herewith a cheque on the Company's Bankers for £ : : , the amount of the deposit paid by you.

To .....

.....  
Secretary.

THE PUBLIC COMPANY LIMITED

(Twopenny  
stamp).

.....  
..... Co. .... 19..

To the . . . . Bank, Ltd.,

Pay to the Order of . . . .  
the sum of . . . . the amount of deposit paid on  
application for Shares of this company not allotted

£ : :

.....

..... } Directors.

.....  
Signature of Payee  
T.C. or M. ....  
Secretary.

(f) UNDER-SUBSCRIPTION. If the issue has been under-subscribed there will be no difficulty in allotment for all applicants will be satisfied in full. The only persons, other than stags, who will be disappointed will be the underwriters, whose application forms should now be filled in for the number of shares they are liable to take up, and the particulars entered on the application and allotment sheets. Where underwriter's cheques have not already been paid in to the bank they should be paid in forthwith.

Where the whole of the issue has not been under-written the directors will have to consider whether the



result of the issue will provide them with sufficient working capital, and if not, whether it can be provided from other sources.

Where the subscription is in connection with a first issue, and has resulted in the provision of inadequate capital, the following courses will probably be open to the directors—

(1) To raise a loan from the bank on the collateral security of debentures, together with their own personal guarantees, which latter will usually be required by the bank in addition to the security of the debentures; or

(2) To create a market for the sale of the unissued shares, paying heavy commissions on placing the shares together with brokerage. As this procedure may take some little time to come to fruition it may be necessary to obtain postponement of the date of completion.

(3) To return all application moneys to applicants without allotting any shares.

(g) ALLOTMENT OF SHARES FOR A CONSIDERATION OTHER THAN CASH. Where shares are allotted to vendors, or nominees of the vendors, in full or part payment of the purchase consideration, or to other persons for a consideration other than cash, Sec. 88 of the Act provides that, within one month of allotment, a contract in writing constituting the title of the allottee shall be filed with the Registrar, together with a return stating the number and nominal amount of the shares so allotted, the extent to which they are to be treated as paid up, and the consideration for which they have been allotted.

Where such a contract as above mentioned is not reduced to writing, the company shall, within one month after allotment, file with the Registrar of Companies the prescribed particulars of the contract stamped with the same stamp duty as would have been payable if the contract had been reduced to writing.

In the case of vendors' shares it will be sufficient if the written nomination of the vendor or a supplementary contract be filed.

Non-filing of these contracts does not now affect the title of the allottee, but there is a penalty of £50 a day for every day during which default continues, in respect of which application for relief from liability may be made to the Court in certain cases. Under Sec. 25 of the Act of 1867, non-filing of these contracts rendered the allottee liable to pay for the shares in cash, but as already stated, this is not now the case.

(h) OFFICE PROCEDURE ON ALLOTMENT. The directors will fill in, on the application and allotment sheets, the number of shares allotted to each applicant. The secretarial staff must then deal with the following work with the utmost despatch—

(1) Application and Allotment Sheets.

(i) Fill in distinctive numbers of the shares allotted and agree them with the total number of shares allotted.

(ii) Fill in amounts due on application and allotment.

(iii) Fill in amounts due on instalments (if any).

(2) Prepare and check allotment letters and despatch them all by the same post, taking care to have proof of postage. The Stock Exchange rules require all allotment letters to be despatched simultaneously.

(3) Complete brokerage and underwriting lists, and prepare cheques for commission.

(4) Prepare, check, and despatch letters of regret, and return application moneys in respect of such applications.

(5) Write up register of members from application and allotment sheets and shareholders' cash book.

(6) Prepare the return of allotment required to be filed with the Registrar of Companies in accordance with Sec. 88 of the Act. This section provides, in

addition to the provisions already stated as to filing contracts in the case of shares issued for a consideration other than cash, that within one month of allotment a return must be made to the Registrar of Companies, stating the number and nominal amount of the shares allotted, the names, addresses, and descriptions of the allottees, and the amount due and payable on each share.

A penalty of £50 a day for wilful default is provided for in the section, but relief may be granted by the Court in the following cases—

- (i) If the omission to file was due to inadvertence.
- (ii) If it was accidental.
- (iii) If the Court considers it just and equitable.

The object of the provisions of this section is to afford persons dealing with the company an opportunity of ascertaining the position of the company with regard to its issued capital.

(7) Make the necessary entries in the financial books as follows—

(i) *Journal Entries.* Debit the respective application and allotment accounts with the total amounts due on application and allotment, and credit the share capital account or debenture account concerned and premiums on shares or debentures account.

Debit the instalment accounts with the amounts due on instalment, and credit the share capital or debenture account.

If debentures are issued at a discount debit the debenture discount account with the discount, and credit the debenture account.

(ii) *Cash Entries.* Enter, from the shareholders' cash book, the total cash received on application and allotment and the cash received on instalments in the main cash book, and post to the credit of application and allotment account or instalment account, as the case may be.

## CHAPTER XI

### MEMBERS AND THEIR RIGHTS AND LIABILITIES

It is the intention of this chapter to deal with membership of a company, showing what constitutes membership, who may become members, the individual rights and liabilities of a member, and how a person ceases to be a member.

#### What Constitutes Membership ?

For the purposes of this question Sec. 24 of the Act clearly divides the membership into two classes—

(1) The subscribers to the Memorandum of the company who are deemed to have agreed to become members, and who must be put upon the register of members as soon as the company is incorporated ; and

(2) All others who have agreed to become members in any other manner whatsoever, and whose names are entered on the register of members.

Neither entry on the register nor allotment is, therefore, necessary to make a subscriber to the Memorandum a member of the company, but registration is necessary to make all other persons members.

These latter persons have only agreed to become members, and it is essential to membership in their case that there shall be both an agreement to become a member and an entry on the register of members, consequently they cannot be members, nor have they the liability of members, until their names are so registered. On the other hand, registration without an agreement to become a member will not make the person, whose name is entered on the register, a member except as shown later by the process of estoppel.

The right to have the name registered can, however, be enforced, by either the company or the other party, either by an application to the Court under Sec. 32 of the Act for rectification of the register, under which procedure a name wrongfully placed on the register can also be removed, or by an action for the specific performance of the agreement of the company to make the other party a member, or of the agreement of the other party to become a member.

A person may, therefore, become a member in any of the following ways—

(1) By becoming a subscriber to the Memorandum, when he will be a member as soon as the company is registered, even though his name is not on the register of members.

(2) By application for and allotment of shares, and the entry of his name on the register of members in respect thereof.

The procedure on an application for and allotment of shares has been fully dealt with in the preceding chapter.

(3) By transfer of one or more shares from another member, and the entry of his name on the register of members in respect thereof. The procedure on a transfer of shares is dealt with later in this chapter.

(4) By allowing his name to be entered on the register of members without objection, or otherwise holding himself out, or allowing himself to be held out, by others as a member. Such conduct will be evidence that he has agreed to become a member, and the principle of estoppel will operate.

(5) By transmission of shares from a deceased, bankrupt, etc., member and entry on the register of members in respect of such transmission. How far such a person can become a member will depend upon the "transmission clause" of the Articles of the company.

## TRANSMISSION OF SHARES AND MEMBERSHIP

Transmission of shares must be distinguished from a transfer of shares as the former occurs only on the death, bankruptcy, etc., of the member, in which cases he has no power to make the transfer himself.

### Shares of Deceased Member.

Sec. 29 of the Act provides that the personal representative, that is to say, the executor or administrator, of a deceased person may transfer the shares or other interest of the deceased member as validly as if such representative had been a member at the time of the execution of the instrument of transfer. This provision allows the legal personal representative to deal with the shares, etc., without himself being registered as a member. He must, of course, prove his title by production of probate or letters of administration, and where a foreign probate has been granted, an ancillary grant must be obtained in this country and produced. The representative of the deceased cannot, however, have a statement entered on the register that he is a trustee, although the fact of production of the proof of his title and a note of the death of the member will be registered.

The extent to which such representative may be registered will depend on the Articles of the company, but as a rule the company will not go into the question who is or is not beneficially entitled to the shares. The Articles usually provide, however, for the registration of the representative as a member on production of the proper evidence of title, but whether he is registered or not, he has a statutory right to deal with the shares.

Where such representatives are registered in their own names they will be personally liable to meet any

calls due on the shares, but will have a right to be indemnified out of the estate of the deceased. Where the shares are merely dealt with by the representatives in their representative capacity, they will have no personal liability as members, but the estate will remain liable for the payment of any calls due on the shares. It will thus be seen that the estate of the deceased will be ultimately liable in both cases, for no representative would allow his name to be put on the register, and accept personal liability, unless the estate he is dealing with is in funds.

A letter of request is usually required from executors or administrators before their names will be entered on the register of members. This letter is a mere formal letter requesting the company to register, as members, the persons concerned. When the request has been complied with a new certificate should be issued, and the letter of request should be recorded and filed as an ordinary transfer.

A transfer of the shares either from the estate or from the representatives to the beneficiaries must, however, be made by the proper instrument of transfer, unless the beneficiary is a sole executor or administrator, when the shares may be put into his name on the authority of a letter of request.

Upon the death of a joint holder of shares, the shares, by right of survivorship, vest in the joint holders surviving. A certificate of death will be sufficient evidence, though it is advisable also to require a certificate of identity to be furnished.

Where personal representatives deal in their representative capacity with part of the holding of the deceased, the balance certificate should be made out in the name of the deceased's estate, and not in the names of the representatives, but not so where they are the registered holders.

It will depend upon the Articles whether or not one of several executors can sell and transfer the shares of the testator. If the Articles are silent on the matter then the general law applies and each of several executors has power to sell and transfer. One of several executors who are registered as shareholders cannot, however, transfer the shares, as personal representatives who have been registered must all sign the transfer, the same as other joint holders.

### **Shares of a Bankrupt Member.**

In bankruptcy the proper person to deal with the shares of the bankrupt is his trustee in bankruptcy, and the evidence of his title, which should be furnished by him, will be either the production of his certificate of appointment or a copy of the *London Gazette* containing notice of it.

Sec. 50 of the Bankruptcy Act of 1883, which has now been incorporated in the Bankruptcy Act, 1914, provided that where any part of the property of the bankrupt consists of stock, shares in ships, shares, or any other property transferable in the books of any company, office, or person, the trustee may exercise the right to transfer the property to the same extent as the bankrupt might have exercised it if he had not become bankrupt.

The shares of the bankrupt thus vest in his trustee in bankruptcy, but such trustee may avoid personal liability, where the shares are not fully paid, by exercising his right of disclaimer, in which case the company may prove for all future calls, and in fact may do so whether the trustee does or does not so exercise his right of disclaimer.

The trustee in bankruptcy alone, therefore, has the right to transfer the shares of the bankrupt.

Sometimes the Articles provide that on the bankruptcy



of any member his shares shall be sold to certain persons, usually the directors, at a fixed price. Such a provision was held to be good in the case of *Borland v. Steel Brothers*, 1901.

### **Shares Held by a Company in Liquidation.**

Where a company in liquidation holds shares in another company, the proper person to deal with such shares is the liquidator of the former company, and he should produce evidence of his appointment, such as a copy of the resolution of the company appointing him in voluntary liquidation, or a copy of the *Gazette* containing notice of his appointment, both in the case of voluntary and compulsory liquidation, or his certificate of appointment in the latter case. The liquidator does not, however, become a member of the company.

### **Shares of a Lunatic Member.**

The shares of a lunatic can be dealt with only in accordance with the terms of an Order of the Court appointing a committee to deal with them. This order, or an office copy thereof, should be produced as evidence of the title of the committee appointed.

The members of the committee do not become members of the company, but are given power by the Court to deal with the shares in the terms of its Order.

### **Endorsement of Production of Evidence of Title.**

In all the aforementioned cases an endorsement of the fact of production should be made on the documents produced as evidence of title to deal with the shares, and a record of the same made in the register of members.

### **WHO MAY BECOME MEMBERS ?**

Any person, even an alien or a bankrupt, may become a member of a company subject to the regulations of

the company which may provide for the exclusion of certain persons.

### **Companies.**

One company may become a member in another company if it has authority to do so in its Memorandum and Articles which authority is almost always, without exception, included in the Memorandum and Articles of companies.

A company may even become a member of another company without this authority in certain cases, for example, where it takes shares in payment of a debt.

A company cannot, however, become a member of itself, and consequently cannot buy its own shares either in its own name or in the names of nominees. There are two reasons for this, firstly, the ordinary law of contract under which a person cannot contract with himself or with himself jointly with other parties, and secondly, that such a purchase would amount to reduction of the company's capital without leave of the Court as required by Sec. 46 of the Act.

### **Firms.**

A partnership should never be accepted as a member for the reasons that, first, it is not a legal entity in England, and secondly, the Stock Exchange will not recognize the delivery of a transfer signed in the firm name as a good delivery. Shares of a company purchased by a partnership can, however, and should always, be registered in the joint names of the partners.

### **Married Women.**

A married woman, subject to the Articles of the company, may hold shares in a company in her own right.

### **Infants.**

An infant may hold shares, but the contract is voidable at his option, for he can repudiate it at any

time within a reasonable time of reaching his majority ; in which case the company will have to refund the moneys paid by him. If, however, the infant has received any benefit from the holding, e.g. received dividends, attended meetings, or exercised voting powers, he would not be allowed to recover moneys paid, and if he does not repudiate within a reasonable time of attaining his majority, his right of repudiation will lapse. While he holds the shares, without repudiation, he will be liable for any calls made during his infancy as well as for calls made subsequently.

In view of the fact that a contract to take shares made by an infant is voidable at his option, companies should never make an allotment to anyone under twenty-one years of age. In fact, to do so knowingly would be a misfeasance on the part of the directors.

### **Fictitious Persons.**

A person who applies for and is allotted shares in a fictitious name will be liable as a member and his true name may be subsequently registered.

### **Persons not Members.**

Persons who agree to place shares or who take debentures, or any other form of loanable capital, do not thereby become members of the company.

The holder of a share warrant is not strictly a member for his name is not on the register, but generally speaking the Articles of the company provide that such a holder shall be deemed to be a member, and he is given all the rights of a member, such as attending meetings and voting, but in this case the share warrant must first be deposited with the company within a stipulated time before the date of the meeting.

### **Evidence of Membership.**

Evidence of the title of the member to the shares or

stock may be contained in a share or stock certificate, or in a share warrant, although in the last named case it has already been stated that it depends on the Articles whether the holder is a member of the company or not.

## SHARE OR STOCK CERTIFICATES

### Issue of Share Certificates.

Sec. 92 of the Act provides that within two months after the allotment or registration of the transfer of any of the company's shares, debentures or debenture stock, the company shall have complete and ready for delivery the certificates of all shares, debentures or debenture stock allotted or transferred, unless the conditions of the issue otherwise provide.

The certificates need not, therefore, be ready for delivery within two months of allotment or registration of transfer where the terms of issue provide for a longer period, but where a shorter period than two months is provided for in the terms of the issue they must be ready within such shorter period.

If the certificates are not so ready, as required by Sec. 92 or as fixed by the terms of the issue, the company and every director, manager, secretary, or other officer of the company who is knowingly a party to the default, shall be liable to a fine not exceeding £5 for every day during which the default continues.

Share certificates should be issued only in exchange for allotment letters, transfer receipts, or balance tickets, such substitutes for the certificate being cancelled at the time of issue.

A useful form of share certificate is given at pp. 178-9.

### Effect of Share Certificate.

Sec. 23 of the Act provides that a certificate under the seal of the company specifying any shares or stock

held by any member, shall be *primâ facie* evidence of the title of the member to the shares or stock.

To be effective, even as *primâ facie* evidence, the certificate must, therefore, be under the seal of the company.

In any case the certificate is not conclusive evidence of the holder's title to the shares mentioned in the certificate, and may be rebutted by the company, but as against any person who has *bona fide* acted to his detriment on the strength of a statement contained in such certificate, as to either title or payment, the company is estopped from denying the truth of its statement.

If, therefore, the company issues a certificate stating that "A" is the holder of the shares mentioned therein when, in fact, the shares belong to some other person, or if the certificate issued by the company states that the shares are fully paid when, in fact, they are only partly paid, it cannot afterwards deny these statements to anyone who has suffered loss by reason of the statements, and it must compensate them.

Where the certificate is issued by an officer of the company without the authority of the company the case is different, and estoppel will not operate. The company may, however, be liable for the negligence of its servant.

The position with regard to forged transfers is dealt with under Transfer of Shares.

### **Lost Certificates.**

The Articles of the company usually provide that where a certificate is lost or destroyed a new one will be provided, usually at a charge not exceeding one shilling, on proof being given of its loss or destruction, but the shareholder will, usually, and should always, be required to give the company a letter of indemnity

against the improper use of the old certificate, and containing an undertaking to return it if it should be found subsequently.

The letter of indemnity will be signed by the shareholder over a sixpenny adhesive stamp. The following is the usual form of such a letter—

*To the Directors,*  
PUBLIC COMPANY, LTD.

In consideration of your issuing to me a duplicate Certificate for  
... .. shares, my original Certificate for  
... .. shares having been lost or mislaid, I  
undertake to save you harmless and indemnify you against any  
costs, claims, actions, or demands which you may bear, sustain or  
be put to in consequence of issuing me such duplicate Certificate as  
aforesaid, and I further undertake to forward the original Certificate  
to you should it eventually be discovered.

6d. stamp.

## SHARE WARRANTS

The use of share warrants in this country is not so popular as is the case on the continent, especially in France, but the Act makes provision for their use if so desired, and they are generally used by companies to facilitate the shares or stock represented by them being dealt with abroad by the holders.

Sec. 37 of the Act provides that a company limited by shares, if so authorized by its Articles, may issue share warrants in respect of any fully paid shares or stock, and may provide by coupons, or otherwise, for the payment of the future dividends on the shares or stock included in the warrant.

The shares or stock in respect of which the warrant is issued must be fully paid. Warrants cannot therefore be issued by a company in the first place, but only in exchange for fully paid shares or stock.

The warrants must be issued under the common seal of the company.

The bearer of a warrant is entitled to the shares or

stock therein specified, and can transfer the same by mere delivery of the warrant, for by mercantile usage a share warrant is a negotiable instrument. It is therefore much easier for a fraud to be committed with warrants than with share certificates, as the transfer of the former is not registered, consequently greater care must be exercised in the issue of share warrants.

The bearer of the warrant, subject to the regulations of the company, is entitled to have his name placed on the register of members on surrendering the warrant for cancellation.

On the issue of a share warrant the company must strike the name of the member out of the register of members, and must enter therein the following particulars—

- (1) The fact of the issue of the warrant ;
- (2) A statement of the shares or stock included in the warrant, distinguishing each share by its number ; and
- (3) The date of the issue of the warrant.

The Articles of the company will decide whether or not the holder of the warrant is to be deemed to be a member either for all purposes or only for particular purposes. If such holders are entitled to receive notice of meetings it will usually be provided that the notice is to be given by advertisement.

The company will be responsible for loss incurred by any person by reason of the company entering in its register of members the name of a bearer of a share warrant in respect of the shares or stock therein specified without the warrant being surrendered and cancelled. It is, therefore, imperative that no re-entry on the register of members be effected unless a formal request has been received from the holder of the warrant, and the warrant is produced and cancelled at the time of such re-entry.

Share warrants cannot form part of the share qualification, if any, required under the regulations of the company to be held by directors or managers.

Any person who falsely and deceitfully impersonates the true holder of such warrant is guilty of a felony, and is liable, upon conviction, under Sec. 38 (1) of the Act at the discretion of the Court, to penal servitude for life or for any term not less than three years.

Sub-section 1 (1) of Sec. 38 of the Act, dealing with the forgery of share warrants, and sub-section 2 of that section dealing with the unlawful engraving of share warrants, have been repealed, but these offences will be dealt with under the Forgery Act, 1913, which makes them a felony, and provides that the offender shall be liable to penal servitude for a period not exceeding fourteen years.

The following particulars as to share warrants must be included in the Annual List and Summary required to be filed in accordance with Sec. 26 of the Act—

- (1) The total amount of shares or stock for which warrants are outstanding at the date of the return; and
- (2) The total amount of share warrants issued and surrendered respectively since the date of the last return.
- (3) The number of shares or amount of stock comprised in each warrant.

Treble the ordinary duty on a transfer of shares is payable on the issue of a share warrant, but no further duty is payable on transfer of the warrant from one person to another. Transfer of a share warrant is effected by mere delivery of the warrant with dividend coupons attached. Delivery of the warrants without such coupons attached is bad delivery.

The issue of share warrants does not in any way affect the constitution of the capital of the company, and no entries or adjustments are required in the financial books.



The following is a specimen of the form of application for share warrants—

Folio. ....

Application No. ....

FORM OF APPLICATION FOR SHARE WARRANTS TO BEARER

To the Directors of

Date Received . ....

THE PUBLIC COMPANY LIMITED.

Dividend House, Golden Street, E.C.2.

Gentlemen,

Number of I/we hand you herewith Registered Share Certificate(s)  
shares must Nod..... for... .. shares bearing the  
be inserted following distinctive numbers .....

standing in my/our name in exchange for which I/we request that you will issue Share Warrants to Bearer for ..... Shares as specified below, and a Registered Share Certificate in my/our name for the balance (if any).

I/we also hand you cheque for £..... the equivalent of the Stamp Duty and Company's Fee, viz.

Bearer Warrants Required.	Stamp Duty		Fee at 1s. per Warrant	Total Charge.
	Per Warrant.	Amount	Amount	
.....for 25 Shares each .....Shares	£ s. d.	£ s. d.	£ s. d.	£ s. d.
.....for 5 Shares each .....Shares	15 -			
.....for 1 Share each .....Shares	3 -			
.....for 1 Share each .....Shares	3 -			
Total Bearer Warrants. .... Shares				
	£	£	£	£

You will please to hold the above Bearer Warrants at the disposal of..... to be exchanged for the receipt which you will issue for the above-mentioned Registered Share Certificate, and hand the Balance Certificate (if any) to..... in exchange for the Company's Balance Receipt.

Yours faithfully,

Signed by the above named Name in full .  
..... Ordinary Signature .....  
in the presence of  
Witness's { Signature .. Description ..  
Address ... Address ..  
Occupation ... Date ..

Please write the above particulars very distinctly.





. The following is a specimen form of application to be entered or re-entered, as the case may be, on the register of members—

Application No. ....

To the Directors of PUBLIC COMPANY LIMITED.

Gentlemen,

I hand you herewith the following Share Warrants to Bearer—

.....for 1 share each	.....	Shares numbered	... to ...
.. . . for 5 Shares each	.....	Shares numbered	„ . . .
.. . . . for 25 Shares each	.....	Shares numbered	... „ . . .

Total ..... Warrants      Total ..... Shares

which I request you to cancel, and for which please hand me a Certificate to the effect that I am registered in the company's books as the proprietor of the said Shares.

I also hand you..... for registration fee, being at the rate of 2s. 6d. per 100 Shares.

Yours faithfully,

Usual Signature	.....
Name in full	.....
Address	.....
Description	.....
Date	.....

Share warrants are usually provided in denominations of £1, £5, £10, £50, and £100, the warrants for each denomination being printed in different coloured ink. The usual form of share warrant issued by companies whose shares or stock are to some extent dealt with in France is shown facing this page.

Holders of the warrants will usually be notified by advertisement when to present the dividend coupons for payment.

A private company cannot issue or take power to issue share warrants since such a company must restrict the right to transfer its shares, and there can be no such restriction in the case of warrants.

## INDIVIDUAL RIGHTS AND LIABILITIES OF MEMBERS

Under this heading it is found convenient to deal with the matters affecting members more in their

individual capacity than as a class, and to which reference has not been made elsewhere in the book.

The matters affecting members, therefore, remaining to be dealt with are—

(1) The transfer, mortgage, forfeiture, and surrender of shares.

(2) The company's lien on the shares.

(3) Calls on shares.

(4) The right to dividends and the procedure with regard to payment.

The rights of a shareholder to attend and vote at meetings and obtain an investigation into the affairs of the company are dealt with in the next chapter.

## TRANSFER OF SHARES

### Right to Transfer Shares.

A member has a statutory right to transfer his shares in accordance with the provisions of the Articles of the company, which may, however, limit his right to make the transfer. In the case of private companies the right must be limited.

Sub-section 1 of Sec. 22 of the Act provides that the shares or other interest of any member shall be personal estate, transferable in manner provided by the Articles of the company, and shall not be of the nature of real estate.

Articles sometimes provide that the shares shall not be transferable where there are calls in arrear, or that a right of first refusal be given to other shareholders before the shares can be transferred to outsiders, and the directors are, in some cases, given power to refuse transfers without assigning any reasons. In this latter case, however, the Stock Exchange will refuse to grant a quotation of the shares of any company giving such a power to directors. Where the power is given to directors it must be exercised in the interest

of the company and not in the interest of a particular party.

Where the Articles make no provision to the contrary the shares of a member may be transferred to anyone, even to an insolvent company or a pauper.

The Articles must, therefore, be referred to in order to ascertain whether any restrictions have been placed upon the shareholders' right to transfer.

Where the company is in course of winding-up transfers can be effected, in the case of compulsory winding-up, only when sanctioned by the Court or the Committee of Inspection, and in the case of voluntary winding-up, with the sanction of the liquidator; otherwise the transfer is void.

### **Form and Execution of Transfer.**

The Articles of the company will decide the form of transfer, and they may provide for the use of a special form or it may be provided that the common form of transfer shall be sufficient. The rules of the Stock Exchange require the common form of transfer to be used in the case of companies desiring an official quotation.

It will thus depend upon the Articles as to whether the transfer is to be by deed or whether mere writing is sufficient. The transfer of shares in companies working under the Companies (Clauses) Act, 1845, must be by deed.

If the Articles are silent as to the form of transfer required then the transfer, being the transfer of a chose in action, must be in writing under Sec. 25 (6) of the Judicature Act, 1873.

It is thought that where the Articles of the company so provide, an oral transfer may be sufficient, but such a form or lack of form of transfer would undoubtedly lead to trouble, for it would be a difficult matter to

deal with the same in making the necessary entries in the books, and would probably lead to many applications for the rectification of the register of members under Sec. 32 of the Act.

The transfer will be executed by the transferor and sent to the transferee, together with the share certificate, when he will also execute it and send it to the company for registration. The transferee will have only an equitable title until the transfer is registered, when his title will be complete.

If one of the parties to the transfer is a limited company the transfer will be executed by writing the words "The Common Seal of the Public Company, Limited, was hereunto affixed in the presence of," and affixing the seal thereto, which should be duly authenticated, usually by two directors and the secretary, as the Articles of the company require.

Where, however, part only of the shares comprised in the certificate are being dealt with, the share certificate will not be sent to the transferee but will be lodged with the company who will certify the transfer. Certification of transfers is dealt with later in this chapter. Delivery of a certified transfer is accepted by the Stock Exchange as a good delivery of the shares.

A transfer may, however, be signed by some other person than the transferor or transferee holding a power of attorney from him. In this case the power of attorney should be registered, and it should be ascertained that the principal is living at the time of execution of the transfer, as the death of the principal revokes the power of attorney. It should also be seen that the power is properly stamped with a 10s. stamp.

A transfer out of the names of joint holders must be signed by them all.

Where a transfer is being made of shares held jointly and purports to be executed by one or more of the

parties on his or their own behalf and as attorney or attorneys for another joint holder, the persons executing the transfer must sign it in both capacities, and produce the power of attorney for inspection before the transfer can be accepted.

The inset shows the common form of transfer.

### Stamp Duty and Fees on Transfer.

The duty on a transfer of stock, shares, or other marketable securities of a company, whether by sale or by way of gift, where the consideration for the sale or, in the case of a gift, the value of the property does not exceed £5, is 1s. Where it

	£	s.	d.
Exceeds £5 and does not exceed £10 . . .	2	—	—
„ £10 „ „ „ „ £15 . . .	3	—	—
„ £15 „ „ „ „ £20 . . .	4	—	—
„ £20 „ „ „ „ £25 . . .	5	—	—
„ £25 „ „ „ „ £50 . . .	10	—	—
„ £50 „ „ „ „ £75 . . .	15	—	—
„ £75 „ „ „ „ £100 . . .	1	—	—
„ £100 „ „ „ „ £125 . . .	1	5	—
„ £125 „ „ „ „ £150 . . .	1	10	—
„ £150 „ „ „ „ £175 . . .	1	15	—
„ £175 „ „ „ „ £200 . . .	2	—	—
„ £200 „ „ „ „ £225 . . .	2	5	—
„ £225 „ „ „ „ £250 . . .	2	10	—
„ £250 „ „ „ „ £275 . . .	2	15	—
„ £275 „ „ „ „ £300 . . .	3	—	—
„ £300 for every £50, and also for any fractional part of £50 of such consideration or value . . .	10	—	—

Where the transfer is to give effect to a gift, or is effected in liquidation of a debt, or is in satisfaction of a legacy or in exchange for other securities, the above *ad valorem* duty is chargeable, and the value upon which it is to be charged will be a matter of agreement between the transferor and the Inland Revenue Authorities.

A nominal duty of 10s. only is payable where the transfer is for mere nominal consideration, that is to



say, where it is effected for any of the following purposes—

(1) Vesting the property in trustees on the appointment of a new trustee of a pre-existing trust, or on the retirement of a trustee.

(2) A transfer, as for a nominal consideration, to a mere nominee of the transferor where no beneficial interest in the property passes.

(3) A transfer by way of security for a loan; or a re-transfer to the original transferor on repayment of a loan.

(4) A transfer to a residuary legatee of stock, etc., which forms part of the residue divisible under a will.

(5) A transfer to a beneficiary under a will of a specific legacy of stock, and is *not* in discharge or partial discharge of a pecuniary legacy.

(6) A transfer of stock, etc., being the property of a person dying intestate, to the party or parties entitled to it.

(7) A transfer to a beneficiary under a settlement on distribution of the trust funds, of stock, etc., forming the share, or part of the share of those funds to which the beneficiary is entitled in accordance with the terms of the settlement.

The parties to the transfer will have to certify on the back of the transfer that the transfer is made under any of the above heads in order to obtain the benefit of nominal duty.

The *ad valorem* duties will, apart from express agreement, be payable by the transferee, who will also be required to pay the company's registration fee, which is usually 2s. 6d.

In addition both the transferor and transferee will have to pay for the contract stamps, and pay the commissions due to their respective brokers on the sale and purchase respectively.

### Forged Transfers.

A forged transfer gives the transferee no right to the shares, even though his name has been entered on the register of members. The rightful owner is entitled to have his name replaced on the register and, if necessary, he can have this right enforced by an application to the Court for the rectification of the register under Sec. 32 of the Act. Neither has the transferee any right to damages against the company in respect of such forged transfer, but if the company issues a share certificate on the strength of the forged transfer and this certificate has been passed on to a *bona fide* purchaser for value, in which case the principle of estoppel operates on the issue of the certificate, the company must compensate such purchaser either by finding other shares for him or by making good their value to him.

In view of this liability on companies, they may, under the Forged Transfers Acts, 1891 and 1892, make compensation out of their funds for damage caused by issuing certificates on the strength of forged transfers or transfers made under forged powers of attorney. The company may create a fund for this purpose either by making an extra charge on transfers, not exceeding one shilling per £100 transferred, or in any other manner it may be deemed expedient. The company has the benefit of the Forged Transfers Acts, whether or not it adopts them in its regulations.

In order to ensure that every safeguard is taken to prevent fraud in connection with transfers a notification of the lodgment of the transfer is sent to the transferor. He is not, however, bound to take notice of such communication, nor is he under any liability if he does not take notice of it, for he is not estopped thereby from denying the validity of the transfer.

### **Liability of Parties to the Transfer.**

The transferor remains liable in respect of the shares transferred until the transfer is registered when, and not before, he ceases to be a member, so far as the shares transferred are concerned, and the transferee takes his place.

Until registration of the transfer takes place the transferor will, therefore, remain liable to the company for the payment of all calls that become due between the dates of execution and registration of the transfer, but there is an implied contract on the part of the transferee to indemnify him against such liability.

The transferor is under no obligation to get the transferee registered as a member, but he impliedly undertakes to do nothing to prevent the attainment of that object.

Even when the transfer is registered the transferor has a contingent liability, under Sec. 123 of the Act, if the shares are only partly paid; for if the company goes into liquidation within one year of the registration of the transfer he is liable to be placed upon the "B" list of contributories. He cannot, however, be called upon in this case, unless—

(1) The "A" list of contributories has first been exhausted;

(2) His own transferee has failed to meet his liability; and

(3) There are debts existing which existed at the time he ceased to be a member.

Until registration is effected the transferee has neither the liability nor the rights of a member, but as already mentioned, he is under liability to indemnify his transferor against the payment of calls.

The right of either party to any dividend that may be declared immediately after the registration of the transfer will depend upon the terms of the contract.

If the shares have been sold to the transferee cum dividend the price of the shares will include the accrued dividend and he will, therefore, be entitled to it ; where owing to non-registration of the transfer in time for the payment to be made direct to the transferee the dividend has been paid to the transferor, he must hand it on to the transferee. The transferee's broker will usually collect this from the transferor's broker, the necessary adjustments being made in their client's accounts. On the other hand, where the shares are sold ex dividend, the price will not include the accrued dividend, and the transferor will be entitled to it when paid.

### Method of Dealing with Transfers.

The following is the routine carried out in a well organized office for dealing with transfers.

(a) CERTIFICATION OF TRANSFERS. The transfer, together with the relevant share certificate, will be presented at the office by the transferor's broker for certification ; that is to say, the share certificate will be lodged with the registrar of the company, who will certify on the face of the transfer that it has been so lodged, thus—

#### THE PUBLIC COMPANY, LIMITED

Certificate for ..... shares has been lodged at the  
company's office .....

.....  
Registrar or Secretary.

DIVIDEND HOUSE  
Golden Street, E.C.2.

In the case of provincial transfers, in order to expedite the transfer, the broker may lodge the certificate with the Secretary of the particular provincial Stock Exchange, who will certify the transfer and despatch the

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(2) His own transferee has failed to meet his liability ; and

(3) There are debts existing which existed at the time he ceased to be a member.

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DIVIDEND HOUSE  
Golden Street, E.C.2.

In the case of provincial transfers, in order to expedite the transfer, the broker may lodge the certificate with the Secretary of the particular provincial Stock Exchange, who will certify the transfer and despatch the

share certificate to the company, together with particulars of the transfer against which the certification has been made.

The certification of the transfer carries no guarantee that the transfer will be registered when subsequently presented for registration. Nor does certification warrant the transferor's title or that the certificate lodged is valid. It merely states that a certificate in respect of so many shares has been lodged, but where the certification states that so many "fully paid" shares have been lodged it has been held that a company is estopped from denying subsequently that the shares are so fully paid. The company has apparently no liability where a transfer has been certified in mistake when in fact no certificate has been lodged.

A transfer may be certified even though it be unstamped, or the consideration is not shown, or it is undated, but it should not be certified if the names of the transferor or transferee or the description of the shares or debentures are omitted.

The particulars of the certified transfer should be entered on the back of the share certificate (*see* specimen Certificate between pages 178 and 179). The certificate should be immediately cancelled by means of a perforating "cancelled" stamp, and carefully filed for future reference.

If the whole of the shares comprised in the certificate are not included in the transfer a "Balance Receipt" should be prepared and handed, together with the certified transfer, to the transferor's broker on completion of certification. This Balance Receipt can be dealt with in the same manner as the original certificate, and certifications may be made against it in the manner already outlined for certificates, except that the particulars of further certifications will not be endorsed

on the Balance Receipt, but will be endorsed on the original certificate, such receipt being cancelled immediately.

If the Balance Receipt is retained by the transferor he will be entitled to exchange it in due course for a balance certificate. A form of Balance Receipt is given on page 182.

Certification may also be made against transfer receipts where the purchaser desires to sell the shares before registration, but these are properly dealt with under Registration.

(b) REGISTRATION OF TRANSFERS. The transfers, duly executed and stamped, will in due course be presented by the transferee's broker at the transfer office of the company for registration, together with the amount of the registration fee. It will be observed that it is here stated that the transferee's broker will present the transfer for registration; this is the usual practice, but Sec. 28 of the Act makes provision for its presentment by the transferor as follows—

28. On the application of the transferor of any share or interest in a company the company shall enter in its register of members the name of the transferee in the same manner and subject to the same conditions as if the application for the entry were made by the transferee.

So soon as the transfer is received for registration the transferor should be notified of the fact, and that if he does not raise objection within a stipulated time, usually by return of post, the transfer will, subject to the approval of the directors, be registered in due course. A specimen form for use in this connexion is given on page 179. Some companies prefer to send out this notice when the transfer is presented for certification, but, in this case, the transfer may never be received for registration, and for that reason it is considered better to send out the notice in the manner prescribed above.



On receipt of the transfer for registration the following work should be performed—

(1) Number each transfer as received, and enter the number against the particulars of the certification endorsed on the back of the old certificate. This will indicate, on future reference, that the transfer has been presented for registration.

(2) Compare transferor's signature with any specimen signature in the office, e.g. the signature on the original application form or as the transferee on a previous transfer.

(3) See that both the signatures of transferor and transferee are properly authenticated, and where either party is a limited company see that its seal has been affixed in a proper manner.

(4) See that the shares or debentures are properly described on the transfer, although this may very well be done on certification.

(5) See that the Inland Revenue Stamp covers the consideration, as any person whose duty it is to register will be liable to a fine of £10 under Sec. 17 of the Stamp Act, 1891, if the transfer is not properly stamped.

(6) Hand, or send by post, transfer receipt to the transferee or his broker. This will later be exchanged for a certificate if the transfer is passed. In the meantime the transfer receipt will take the place of the certificate, and certification may be made against it in the same manner as already described for certification against certificates and balance receipts. Form of Transfer Receipt is given on page 180.

(7) Prepare certificate in the name of the transferee.

(8) Where a transfer audit is to be carried out inform the auditors that the transfers are ready to be checked, and obtain their certificate when the audit has been completed.

(9) On completion of the work detailed above, the

secretary will present the transfer to be passed by the directors either at the next board meeting or at a meeting of a committee of directors appointed to deal with them.

The auditor's certificate should be produced to the directors with the transfers; and the new certificates and balance certificates, relating to the transfers which have been passed, will be sealed, signed, and dated at the meeting.

(10) The necessary entries must now be made in the register of members, by which the transferors' accounts will be credited and new accounts opened in the names of the various transferees debited, with the shares transferred, upon which entry being made the transferee becomes a member of the company. Where, however, the transferee is already entered upon the register as a holder of other shares of the same class, the debit will be made in the share account already opened.

(11) On receipt of transfer and balance receipts, despatch the certificates relating thereto to the respective transferees and transferors. Care should be exercised to ensure that no certificate shall be issued except in exchange for such receipts.

(12) Secure the cancelled certificates to their respective counterfoils in the share certificate books.

A transfer of shares does not in any way affect the financial books of the company, except that the fees payable to the company should be recorded therein.

## MORTGAGE OF SHARES

A shareholder may raise money on his shares, if any value attaches to them, by mortgaging them to some other person. Up to two-thirds of the value of the shares may usually be advanced, according to the standing of the company, on the security of such mortgage.

The mortgage may be effected either by an actual transfer of the shares to the mortgagee, in which case when entered on the register he will become a member and liable for the payment of calls, or by the deposit of the share certificate with him, together with a blank transfer signed by the mortgagor. In the former case the mortgagee will have a legal mortgage of the shares, but in the latter case he will have only an equitable title.

In the case of an equitable mortgage where there is a deposit of a blank transfer, the position of the mortgagee with regard to such transfer will depend upon whether the Articles provide that the transfer shall be by deed or merely in writing.

Where the Articles require the transfer to be by deed a blank transfer will be ineffective, as a deed must be signed, sealed, and delivered. In this case, therefore, a blank transfer cannot be filled in unless there be also a power of attorney, as otherwise it would not have been executed as a deed. It is quite clear, however, that the mortgagee would have an equitable title to the shares and could enforce the mortgage as an agreement by the mortgagor to give him a legal title by providing him with a proper transfer.

Where, however, the Articles of the company merely require the transfer to be in writing, the deposit with the mortgagee of a transfer with the name of the transferee omitted, signed by the mortgagor, operates as an authority to the mortgagee to fill in the blank by inserting either his own name or the name of a purchaser.

If the loan is not repaid within the stipulated time the mortgagee may either fill in his own name as transferee, and have the transfer registered, or he may sell the shares on giving reasonable notice to the mortgagor.

As the company is not bound to take notice of trusts or equities a loophole for fraud is apparent in these forms of mortgage, as there is nothing to prevent the mortgagor writing to the company, stating that he has lost his original certificate, and, on giving the company a letter of indemnity, obtaining a new one which he may utilize in selling the shares. This difficulty may be surmounted by the mortgagee giving the company notice, under the Rules of the Supreme Court, by what is termed "Notice in lieu of Distringas." Under these rules the mortgagee must prepare an affidavit stating the extent of his interest in the shares or stock described in the notice accompanying the affidavit. This affidavit and notice must be filed at the Central Office of the Supreme Court, where he should obtain an office copy of the affidavit, and a duplicate of the notice authenticated by the seal of the Central Office, which he will serve on the company by leaving them at the registered office of the company.

The company is bound to take notice of such "Notice in lieu of Distringas," and cannot, in consequence, register any transfer or pay dividends in respect of the shares or stock covered by the notice until due notice has been given to the mortgagee by the company that it will register the transfer unless he takes steps to prevent it within eight days. The company cannot, however, refuse to register the transfer after the expiration of the eight days unless the mortgagee has commenced proceedings.

## FORFEITURE OF SHARES

### **The Right to Forfeit Shares.**

The right of the directors to declare the shares of any member forfeited must be provided for by the Articles of the company, otherwise there is no such right.

Articles do, however, usually give the directors power to forfeit shares for some reason arising out of the liability of the members as the non-payment of calls. The forfeiture must be made in strict accordance with the terms of the Articles, and must not be illegal.

Where the Articles do not make provision for forfeiture the power can be taken by altering them by special resolution.

Companies working under Table "A" of the Act must abide by the provisions as to forfeiture contained in Articles 24-30 of that Table, which are set out in Appendix "A" to this book.

Before the directors can proceed to forfeiture of shares the Articles usually provide that notice shall first be served on the member requiring him to pay within a stipulated time the calls due, together with any interest due thereon, and all expenses to which the company may have been put by reason of non-payment of the sums due. The notice should state where such moneys are to be paid and that, in the event of non-payment within the stipulated time, usually not less than fourteen days from the date of the notice, the shares in respect of which the moneys are due will be liable to forfeiture.

If this notice is not complied with the directors may then proceed to forfeit the shares by passing a resolution to that effect, and giving notice of it to the member.

The provisions of the Articles must be strictly adhered to, otherwise the Court may, on application, declare the forfeiture void.

The right to forfeit shares is in the nature of a trust to be exercised by the directors for the benefit of the company, and must not be used as a means of allowing any particular member or members to escape their liability on the shares.

A forfeiture of shares may be made even if the company is in voluntary liquidation, for while the liquidator cannot himself declare the shares forfeited, the power to forfeit being vested in the directors, yet he may call upon the directors to exercise that power. It is unlikely, however, except in the case of reconstruction of a company, that the liquidator would desire to have such a right exercised.

### **Liability in Respect of Shares Forfeited.**

On forfeiture of the shares the holder ceases to be a member. The liability of the holder after forfeiture will depend entirely upon the Articles of the company, which may provide that he shall remain liable in respect of all calls outstanding at the date of forfeiture, together with any interest due thereon. Apparently there can be no liability in respect of future calls.

Where there is a liability for outstanding calls provided for by the Articles, the company may sue the person liable for the amount due, even after forfeiture, but his liability is that of an ordinary debtor as he has no liability as a member, for on forfeiture of his shares he has ceased to be a member. He will, however, remain liable under Sec. 123 of the Act until the expiration of one year from the date he ceases to be a member.

Where shares have been wrongly forfeited, the person aggrieved may sue the company for annulment of the forfeiture, or prove in a winding-up of the company in competition with the ordinary creditors of the company, thus gaining priority over the other shareholders.

Where the company sells the shares on forfeiture, the person acquiring them will be liable for the calls outstanding, but it is usual in such a case to sell at a price which includes the payment of outstanding calls.

**Forfeited Shares and the Company.**

The company cannot cancel the shares which have been forfeited, as this would amount to a reduction of capital without the leave of the Court required by Sec. 46 of the Act. The shares may, however, be sold by the company at whatever price they will fetch, provided the amount paid for the shares by the purchaser plus the amount already received by the company from the previous holder is not less, altogether, than the par value of the shares.

**Annulment of Forfeiture.**

The Articles, in addition to giving the directors power to forfeit shares, may also give them power to annul a forfeiture, but where power is given to annul the forfeiture the directors cannot replace the name of the person holding the shares on the register of members without his consent.

**Method of Dealing with Forfeiture in the Books of the Company.**

The date and particulars of the resolution forfeiting the shares and the date the notice of forfeiture requiring payment was despatched, should be recorded in the delinquent's account in the Register of Members and Share Ledger. This account should then be credited with the shares forfeited and an account, opened in the Register under the heading of Forfeited Shares, should be debited. The distinctive numbers of the shares will be recorded in both accounts.

In the financial books the following records of the forfeiture should be made—

(1) Debit the Share Capital Account with the full amount called up on the shares, which will equal the amount which has been previously credited to that account in respect of the shares.

(2) Credit the Allotment or Call Accounts, as the case may be, with the amounts included in the balances of these accounts as being due from the shareholders in question.

(3) Credit Forfeited Shares Account with the difference between items (1) and (2), shown above. This difference will equal the amount actually received from the shareholders in respect of the shares forfeited.

There are other methods of dealing with forfeited shares in the financial books, but the one outlined above is the one recommended.

On a re-issue of forfeited shares the Forfeited Shares Account in the Register of Members and Share Ledger should be credited with the number of shares sold and the respective purchasers' accounts debited, the distinctive numbers of the shares being, of course, also recorded in both accounts.

In the financial books the following entries should be made on the re-issue of forfeited shares—

(1) Credit Share Capital Account with the full amount due on the shares at the time of re-issue.

(2) Debit Sundry Shareholders Account with the full amount due on the shares as in (1).

(3) Debit Cash with the amounts received from the purchasers of the forfeited shares, and post these items from the Cash Book to the Credit of Sundry Shareholders Account.

(4) Debit Forfeited Shares Account with the amounts received from the previous holders in respect of the forfeited shares now re-issued, and Credit Sundry Shareholders Account therewith. This entry gives effect to the right of the purchaser of forfeited shares to be credited with any sums paid by the previous holder.

(5) If there remains a credit balance on Sundry Shareholders Account, such balance should be transferred to Premiums on Shares Account or to a Capital



Reserve Account, as it represents a capital profit to the company on the re-issue of the shares. There cannot be a debit balance on the Sundry Shareholders Account for, as previously stated, the company cannot re-issue the forfeited shares at a price which together with the payments received from the previous holder is less than the par value of or the amount due on the shares if the full nominal value has not been called up.

### SURRENDER OF SHARES

The Articles of the company sometimes give directors power to accept surrenders of shares, but such a surrender would be effective only where it is used as a short way to forfeiture when the right to forfeit the shares has arisen, but not otherwise.

The surrender of fully paid shares in exchange for other fully paid shares of the same nominal value has, however, been held to be valid, although it was at one time thought that such a procedure amounted to a purchase by the company of its own shares, which is illegal by reason of the fact that a company cannot be a member of itself.

A surrender of shares made with the object of relieving a member from liability is also void.

### LIEN ON SHARES

The Articles of the company generally make provision that the company shall have a paramount lien on the shares of its members for debts or calls due from them.

This lien will extend to debts other than calls, and also attaches to dividends. Generally speaking, the lien is made to apply only to shares not fully paid up, as the Rules of the Stock Exchange require that such lien shall not extend to shares which are fully paid.

If the Articles do not make provision for this lien they may be altered by special resolution, or where the

lien affects only partly paid shares it may be extended in like manner to attach to fully paid shares.

The company may enforce its lien by sale if the power to do so has been taken by the Articles or by special resolution altering the Articles, provided the terms of the Articles or the resolution are strictly complied with as to the notice to be given to the shareholder before sale. The company cannot, however, enforce its lien by forfeiture of the shares, as this would amount to a clog on the equity of redemption.

The lien can be enforced even though the shareholder is a trustee, as the company is entitled to ignore all trusts.

The company will not have priority, in respect of the lien, over a mortgage of which it has notice before the shareholder became indebted to the company, unless the Articles provide that any mortgagee effecting a mortgage with notice of the company's lien shall be postponed to that lien.

### CALLS ON SHARES

When, under the provisions of a prospectus, the full nominal amount of the shares is not required to be paid on allotment, it is very often provided, in the terms of the prospectus, that the balance due on the shares shall be paid in one or more stipulated amounts on certain fixed days. Such amounts are not, strictly speaking, calls, and should be referred to as instalments, as they are not payable under a call made by directors but under the terms of a prospectus.

Any calls made must be effected in the manner provided by the Articles, which usually give power to the directors to make calls as and when they consider necessary, but the power is in the nature of a trust, and must be exercised in the general interests

of the company, and not merely for the purpose of paying directors' fees.

Directors cannot make a call upon some members while allowing others of the same class to go free, unless the Articles otherwise provide, as there is, *primâ facie*, an implied equality between shareholders of the same class, but they can make a call upon one class of shareholder without making a similar call on another class.

The directors must take all necessary steps, by action, notice of forfeiture, or in any other manner to enforce the payment of calls, otherwise they will be guilty of a breach of their duty.

Interest may be charged on any calls in arrear if the Articles so provide, and the rate of interest charged will usually also be fixed by the Articles.

The terms of an issue of shares or debentures by prospectus usually provide for the payment of interest at the rate fixed by the prospectus on outstanding instalments.

The directors may also receive payment of calls in advance, and pay interest thereon if the Articles give them power, but this right is in the nature of a trust, and must be exercised only if the directors consider that benefit will accrue to the company by utilizing such payments in the business in advance of calls.

A call becomes statute barred if it is not paid within twenty years of the date it was made. A call is made on the day the resolution is passed, and not when notice of it is given to the shareholder.

Sec. 39 of the Act provides as follows—

39. A company, if so authorized by its Articles, may do any one or more of the following things, namely—

(1) Make arrangements on the issue of shares for a difference between the shareholders in the amounts and times of payment of calls on their shares:

(2) Accept from any member who assents thereto the whole

or a part of the amount remaining unpaid on any shares held by him, although no part of that amount has been called up :

(3) Pay dividends in proportion to the amount paid up on each share where a larger amount is paid up on some shares than on others.

When the call is made the amounts due should be entered in the Call Book, or where the Application and Allotment Sheets are made to do the duty of such a book, then on such sheets, from which the items will be posted to the debit of the Cash Account portion of the accounts in the Register of Members and Share Ledger.

The cash received will be recorded in the Shareholders Cash Book, and posted therefrom to the credit of the respective shareholders' accounts in the Register of Members.

In the financial books the total amount due in respect of calls will be journalized, from which entry in the journal the call accounts in the ledger will be debited, and the particular share capital account credited.

The total of the cash received in respect of calls will be entered in the company's main cash book from the Shareholders Cash Book, and posted to the credit of the call accounts.

Calls in arrear should be shown in the balance sheet of the company, on the liabilities side, as a deduction from the paid-up capital, and not shown as a debt on the assets side, as the paid-up capital would otherwise be incorrectly stated.

## DIVIDENDS

### Nature of Dividends.

Dividends are the periodical distributions of cash or bonus shares made by a company out of the profits earned by it during each financial period.

Dividends must, however, be paid in cash unless the Articles authorize a distribution of profits by way of an issue of bonus shares.

The distinctions between dividends and interest have been set out on page 52, but it may be as well to emphasize here that dividends on shares should never be referred to as interest, and interest on debentures or other forms of loanable capital should never be styled dividends.

Dividends may not be paid out of capital, that is to say, dividends can be paid only out of profits, but these profits may, unless the Articles of the company otherwise provide, be either realized capital profits, e.g. premiums on shares or profit on the sale of an asset, or revenue profits which are the profits earned by the use of the capital employed in the business. Interest on calls paid in advance is payable out of capital, as is also the case with interest on loanable capital, and Sec. 91 of the Act makes provision for the payment of interest on the paid-up capital of certain classes of companies in specified cases, but this payment is styled interest, not dividend.

Sec. 91 provides that where any shares of a company are issued for the purpose of raising money to defray the expenses of the construction of any works or buildings or the provision of any plant which cannot be made profitable for a lengthened period, the company may pay interest on so much of that share capital as may be for the time being paid up for the period, and may charge it to capital as part of the cost of construction of the work or building, or the provision of plant. Such interest is, however, payable only under the following conditions—

(1) It must be authorized by the Articles of the company or by special resolution.

(2) Even when so authorized, before payment can

be made, the previous sanction of the Board of Trade must be obtained, and before giving its sanction the Board of Trade may, at the expense of the company, appoint a person to investigate and report to them on the circumstances of the case. The Board of Trade may also require the company to give security for the costs of such inquiry.

(3) The payment can be made only for such period as the Board of Trade determine, which period can in no case extend beyond the expiration of six months from the end of the half year in which the buildings have been actually completed or the plant provided.

(4) The rate of interest paid must not in any case exceed 4 per cent per annum, but a lower rate of interest than 4 per cent may be prescribed by Order in Council.

(5) The payment of interest is not to operate as a reduction of the amount paid up on the shares in respect of which it is paid, but will be charged as part of the cost of construction.

(6) The accounts of the company must show the share capital on which, and the rate at which, interest has been paid out of capital during the period to which the accounts relate.

The object of these provisions is to make some compensation to shareholders for the delay in reaching a revenue earning stage caused to the company by the construction of buildings or plant.

Dividends must be declared in accordance with the Articles, and unless the regulations otherwise provide, are payable in proportion to the amount of nominal capital held by each shareholder, irrespective of the amount paid up.

The Articles usually empower directors to declare and pay interim dividends if the profits, in their opinion, are sufficient, and apparently all dividends

may be thus declared as interim dividends without there ever being a final dividend.

Where dividends declared by directors have to be sanctioned by the company in general meeting, or where power to declare dividends is given to the general meeting absolutely, the shareholders will not be allowed to declare a dividend at a higher rate than that recommended by the directors, nor can they force directors to pay a dividend out of capital. They can, however, resolve that a lower rate of dividend be paid, but this power is rarely exercised by shareholders.

Dividends become barred by the Statute of Limitations if they are not claimed within twenty years from the date they are declared. Shareholders may, however, lose the right to the dividend within a much shorter period than twenty years where there is a provision in the Articles of the company to the effect that dividends shall be forfeited if not claimed within a specified period. Where, however, a quotation of the shares is desired on the Stock Exchange, the rules of that body prohibit such a provision in the Articles, and consequently it must be omitted.

Dividends become debts when they are declared, and can then be sued for by shareholders.

Before declaring dividends, directors have an implied power to put to reserve such sums as they consider necessary, but this implied power may be negatived by the Articles. The power to put to reserve must, however, be used in the interests of the company, and not with the sole object of withholding profits from a particular class of shareholders.

In declaring dividends the rights of different classes of shareholders must be preserved, that is to say, an ordinary dividend cannot be paid without first satisfying the rights of the preference shareholders.

The rights of preference shareholders to dividend, and the distinction between cumulative and non-cumulative dividends has been fully dealt with in Chapter IV of this book.

### **What are Profits for Dividend Purposes ?**

It has been already stated that the law provides that dividends shall not be payable out of capital, but it does not clearly define out of what accretions to capital they may be paid. Capital in this respect legally means moneys subscribed in pursuance of the terms of the Memorandum of the company.

The difficulty in deciding what are profits for dividend purposes centres mainly round the provision for depreciation of the assets, the necessity for which the law discriminates between the nature of the assets themselves, dividing them into wasting, fixed, or circulating capital, to which accountants would refer more correctly as wasting, fixed, or floating assets.

It is considered unnecessary in a book of this character to go into the multitude of cases which have been decided as to the meaning of "Profits available for distribution," but the following may be taken to be a fairly accurate statement of the legal attitude towards the question—

(1) Profits may be available for dividend even though provision for depreciation on fixed or wasting assets has not been made. Fixed assets are those which are more or less permanently used in the business with the object of earning income, such as freehold land and buildings, plant and machinery, etc. Wasting assets are those which are exhausted in the process of earning income, e.g. a mine or a cemetery.

(2) Depreciation of floating assets must be made good before payment of a dividend. Floating assets are those which are not permanently held in the



business, but which are used with the object of being subsequently converted into cash or its equivalent, e.g. stock in trade, bills receivable, debtors, etc.

(3) A company may revalue its assets at the end of each period, and set off any appreciation in value against a revenue loss.

(4) Each financial period may be dealt with separately from any preceding period. That is to say, if there is a profit on the period under review the law allows such profit to be distributed, although a loss may be standing to the debit of the revenue account of the preceding period.

(5) Realized capital profits may be distributed unless there is anything to the contrary provided in the regulations of the company. The capital profits made available for distribution must, however, be realized profits as distinct from book or paper profits.

This is a statement of the legal position, but any business man will readily see that it would be impossible to continue the business for very long on these lines, without liquidation quickly ensuing. For example if depreciation is not provided for on fixed assets, in addition to repairs and small renewals, no fund will be created, either inside or outside the business, from which to replace such assets as plant and machinery when worn out ; this would mean that the business would either have to raise further capital, which would water the company's capital to that extent unless it is simultaneously reduced by some capital reduction scheme, or alternatively, wind up the business. The same state of affairs would result where a debit standing to the revenue account is not first made good out of future profits before payment of a dividend, for in time the whole of the capital may thus be lost without any part of it having been made good, liquidation being the inevitable result.

The commercial view of what are profits for the purpose of dividends should always be strictly adhered to in business, and the legal view disregarded if the success of the business is to be attained.

Under the commercial view provision should be made for all depreciation other than that arising on wasting assets, and all contingencies such as reserving against doubtful debts, before paying any dividend. Appreciation in the value of assets is rarely considered, as it is generally transitory and, where the assets are written up, it, generally speaking, only results in a subsequent writing down. Realized capital profits should be put to a capital reserve account or utilized for writing down intangible assets.

Profits available for distribution, having regard to the maintenance of the security of the business, must mean in business *net* profits (arrived at after providing for all depreciation) less any sums put to reserve ; which commercial definition takes much beyond the legal requirements. For the purpose of fixing the liability of directors for the payment of dividend out of capital or other legal liability, the legal view as to available profits must, of course, be taken.

### **Liability of Directors in Respect of Dividend Paid Out of Capital.**

Directors are liable to refund to the company any dividends they may pay out of capital, together with interest at the rate of 5 per cent.

In the case of an interim dividend, since the directors are more entitled to rely upon estimates and opinions, if in the opinion of the Court they were justified in believing that the dividend was warranted, each director would be liable to refund only the amount he himself has received. In the case of a final dividend, however, directors are supposed to be in possession

of all the facts, and will have full liability unless it can be shown that they were misled as to the position of affairs by some person on whom they were entitled to rely or unless they obtain relief from the Court under Sec. 279.

Any director who has been forced to meet this liability can claim contribution from his co-directors equally liable.

Where members receive dividends with the knowledge that they are paid out of capital they must refund them, and the directors' liability will then be reduced by the amount of such refund.

Where directors find, after declaring an interim dividend, that if it is paid it will have to be paid out of capital, they may cancel the declaration at any time before payment is made.

### **Method of Paying Cash Dividends.**

The payment of dividends requires the exercise of great care and expedition on the part of the secretarial or transfer office staff, consequently the work entailed must be carried out in a systematic manner. The following method of preparation for and payment of dividends has been found to work smoothly in practice—

(1) Ascertain the exact terms of the resolution declaring the dividend.

(2) Ascertain the equivalent rate of tax to be deducted from the dividends. For this purpose, where there has been a change in the rate of tax during the period of the company's accounts in respect of which the dividend is declared, the standard rate of tax for the two fiscal years in which the company's financial period overlaps must be adjusted to the proportionate standard rate covering the whole period of accounts, e.g. where the company's period ends in June and the standard rate of tax for the fiscal year

ended on the 5th April (which for all business purposes may be taken to be the 31st March) of the year covered by the company's accounts is 5s. in the £, and the standard rate of tax for the following fiscal year is 4s. in the £, the rate of tax to be deducted from dividends would be 9 months at 5s. in the £, and 3 months at 4s. in the £, that is to say, 4s. 9d. in the £.

(3) Give necessary instructions to printers to print the warrants and submit proof, which should be passed by the directors. The requirements of Sec. 33 of the Finance Act, 1924, which are dealt with later, must be observed in this respect.

(4) The dividend on the total capital should then be worked out and tax at the appropriate rate deducted therefrom. This will give the total cash required to pay the net dividend.

(5) Instruct the bank to make a transfer of the net amount ascertained under (4), from the company's general account to a special dividend account, e.g. Preference Dividend Account No. 5.

(6) Prepare the Dividend List, using separate lists for each class of shareholders, and agree the total of such list, as to number of shares, with the total shares issued, and as to cash, with the figures ascertained above under (4).

A suitable ruling for such a Dividend List is as follows—

PREFERENCE DIVIDEND LIST No. 5

Folio in Register of Members.	Name of Share- holder.	Address.	No. of Shares.	Gross Dividend	Income Tax @	Net Dividend	Warrant No.	Remarks

Any special instructions which may have been received requiring payment of dividend to parties other than the shareholders or any notice in lieu of distingas should be noted on the dividend list.

(7) Prepare the dividend warrants from the dividend list, and despatch on the day fixed by the Board.

(8) Check dividend list with the dividend pass book, and tick in blue pencil the items which have been cleared.

The payment of a dividend will not be recorded in any way in the Register of Members and Share Ledger.

In the financial books, cash will be credited with the net dividend when paid, and will be posted from the cash book to the debit of Dividend Account. Dividend Account will also be debited, and Income Tax Account or Commissioners of Inland Revenue Account credited, through the journal, with the total amount of tax deducted from the gross dividend.

The balance of the Dividend Account will eventually be transferred to that part of the Trading and Profit and Loss Account termed the Appropriation Account.

### **Dividend Warrants.**

The payment of dividends on registered shares or stock is made by means of a document termed "Dividend Warrant."

A dividend warrant is usually divided into two parts, which serve the following purposes—

(1) The top part of the warrant is made to act—

(a) As notice of the payment of the dividend to the shareholder; and

(b) As a voucher for the payment of income tax, which will support any claim made by the shareholder for repayment of tax shown thereon as having been deducted.

(2) The lower part of the warrant serves in the dual capacity of a cheque for the payment of the dividend

and a receipt for such payment, as the payee is usually required to sign it before payment.

The shareholder will, therefore, keep the top part of the warrant and detach and pay the lower part, which is generally crossed, into his bank, which latter part will eventually find its way back to the company.

Where dividend warrants are lost, stolen, or strayed, payment of them should be immediately stopped by giving the necessary instructions and particulars to the bankers.

It is advisable to have several copies of the top part of the warrant available in case they are subsequently required as vouchers for income tax by shareholders, who have mislaid or lost the top part of the warrant already sent them.

In the past there has been a great difference in the form of warrants used by various companies. In some cases it was left to the shareholder himself to calculate the gross dividend and rate and amount of tax deducted, while in other cases nothing was shown on the warrant except the net dividend payable. This state of affairs has now been remedied by Sec. 33 of the Finance Act, 1924, which came into force as from the 30th November, 1924, and which makes the following provisions—

33.—(1) Every warrant or cheque or other order drawn or made, or purporting to be drawn or made, after the thirtieth day of November, 1924, in payment of any dividend or interest distributed by any company, being a company within the meaning of the Companies (Consolidation) Act, 1908, or a company created by letters patent or by or in pursuance of an Act of Parliament, shall have annexed or be accompanied by a statement in writing showing—

- (a) the gross amount which, after deduction of the income tax appropriate thereto, corresponds to the net amount actually paid; and
- (b) the rate and the amount of income tax appropriate to such gross amount; and
- (c) the net amount actually paid.

(2) If the company fails to comply with the provisions of this section, the company shall, in respect of each offence, incur a penalty of ten pounds :

Provided that the aggregate amount of any penalties imposed under this section on any company in respect of offences connected with any one distribution of dividends or interest shall not exceed one hundred pounds.

In addition to the provisions already stated, the Inland Revenue Authorities also require the following information to be given if the warrant states that the top part of the warrant will be accepted by them in connection with claims to any allowance or relief from income tax—

- (1) The name of the shareholder ;
- (2) The period for which the dividend or interest is declared ;
- (3) The date of payment ; and
- (4) A declaration by the secretary, or other responsible officer of the company, to the effect that income tax on the profits of the company has been or will be duly paid to the proper officer for the receipt of taxes.

A form of dividend warrant which, it is submitted, completely complies with the provisions of Sec. 33 of the Finance Act, 1924, and the special provisions of the Inland Revenue Authorities, is as follows—

### THE PUBLIC COMPANY, LIMITED

#### PREFERENCE DIVIDEND NOTICE AND WARRANT

DIVIDEND HOUSE,  
Golden Street, London, E.C.2.  
1st January, 1925.

No. ...

Dear Sir (or Madam),

In accordance with a Resolution of the Board directing the payment of a Final Dividend on the Preference Shares of 3 per cent, being at the rate of 6 per cent per annum, in respect of the year ended 31st December, 1924, I beg to annex Warrant as follows—

Final Dividend of 3 per cent on . . . . . Preference

Shares, fully paid, held by you . . . . .	£	:	:
Less Income Tax at 4s. 6d. in the £ . . . . .	£	:	:

Net Dividend Payable

£

I hereby certify that the amount stated hereon has been deducted for Income Tax, and will be paid to the proper Officer for the Receipt of Taxes.

This portion to be retained by you. The Warrant requires your signature at foot.

Your Obedient Servant,

..... Secretary.

### PUBLIC COMPANY, LIMITED

#### PREFERENCE DIVIDEND WARRANT

2d  
impressed  
stamp.

No. .... 2nd January, 1925.

To Messrs Coutts & Co.,  
15, Lombard Street, E.C. 2.

PAY TO the Order of .....  
the sum of ..... £

For and on behalf of Public Company, Limited.

£ ..... Directors.

Payee's Signature..... Secretary.

T C or M

This draft must be signed by the Payee and presented within Three Months from date.

### BONUS SHARE ISSUES

Shares cannot be issued as a bonus by a company purely as a gift, so that nothing shall be paid in respect of them, nor can the company take effective power in its Memorandum or Articles to do so.

Where, however, the company's Articles allow, but not otherwise, the company may capitalize the whole or any part of its undivided profits, whether such profits stand to the credit of Profit and Loss Account or have been put to a General Reserve Account, in any of the following ways—

(1) By issuing what are termed " Bonus Shares " in respect of the whole or part of such undivided profits.

The terms of the Articles as to the issue of such shares must be strictly adhered to, and power should



be given to the directors to deal with fractions as they deem expedient.

Where bonus shares are issued on these terms they will be paid for out of profits which have already been taxed, and will not, therefore, be again taxable nor need they be aggregated for super-tax purposes, unless an option be given to the shareholders to take either cash or shares.

The issue of such bonus shares should be recorded in the books in the following manner—

(a) FINANCIAL BOOKS. Journal entries must be made as follows—

Debit the Profit and Loss Appropriation Account or Reserve Account, as the case may be, and credit a Bonus Account in respect of the bonus payable ; and

Debit the Bonus Account and credit Share Capital Account in respect of the issue of the shares.

(b) SECRETARIAL BOOKS. (i) Prepare list of shareholders showing shares held by each, and also the bonus each shareholder is entitled to receive, together with the distinctive numbers of the new shares.

(ii) The shares must then be allotted as fully paid to the shareholders named.

(iii) A contract constituting the title of such shareholders must be filed with the Registrar of Companies, in accordance with Sec. 88 of the Act, together with the required return of allotments.

(iv) Make the necessary entries as to number of shares and distinctive numbers in the accounts of the various shareholders kept in Register of Members and Share Ledger.

Fractions of shares must be dealt with as the directors may instruct.

(2) By declaring a dividend free of tax and giving the shareholder an option to take such dividend in cash or bonus shares.

In this case the procedure will be the same as that described above, except that a Dividend and Bonus List must be prepared, instead of merely a Bonus List, containing a column for cash dividend, and also a column for share dividend.

As tax will have been paid upon the profits from which the bonus is declared the shareholder will not have to pay tax again, but he must in this case aggregate the bonus with his other income for the purpose of super-tax.

(3) By declaring a dividend free of tax upon partly paid shares, at the same time making a call of a similar amount on the shareholders, and by a resolution of the shareholders in general meeting applying the dividend to the payment of the call.

In this case the rules as to payment of dividends and making calls already described in this book apply, the whole transaction being dealt with on a cash basis.

## CHAPTER XII

### MEETINGS OF SHAREHOLDERS AND THEIR RIGHT TO REQUIRE INVESTIGATIONS

IN this chapter meetings of shareholders and their rights as to voting at such meetings are dealt with, but the subject cannot be exhaustively treated in a book of this kind. Board meetings have been already dealt with on page 145 *et seq.* The right of shareholders to require investigations into the affairs of the company are also considered.

### CLASSIFICATION OF MEETINGS

Meetings of shareholders are distinguished in the Act as follows—

- (1) Statutory Meeting.
- (2) Annual General Meeting.
- (3) Extraordinary General Meetings.
- (4) Special Meetings.

Minutes of the proceedings at all these meetings must be kept in accordance with Sec. 71 of the Act, and, when signed by the chairman, they are *primâ facie* evidence of the proceedings at such meetings.

### Statutory Meeting and Report.

Sec. 65 of the Act provides that—

65.—(1) Every company limited by shares and registered on or after the first day of January, 1901, shall within a period of not less than one month nor more than three months from the date at which the company is entitled to commence business, hold a general meeting of the members of the company, which shall be called the statutory meeting.

The Statutory Meeting is usually the first meeting of the company, but it is possible, though it would be

unusual, that, as this meeting cannot in any case be held at a date less than one month from the date the company is entitled to commence business, a General Meeting of the company may be called as the first meeting.

A list of members showing names, addresses, and descriptions must be available for inspection of members during the continuance of the meeting. It is therefore usual to have the Register of Members open for inspection at the Statutory Meeting.

The object of this Statutory Meeting is to provide the shareholders with an early opportunity of inquiring into the conduct of the promotion, ascertaining the position of the company in relation to its membership, and the working capital required to carry on the business, and obtaining information with regard to the future prospects of the company.

Sub-section (7) of Sec. 65 gives the shareholders a statutory right to discuss freely these matters at the Statutory Meeting, and provides—

65.—(7) The members of the company present at the meeting shall be at liberty to discuss any matter relating to the formation of the company, or arising out of the statutory report, whether previous notice has been given or not, but no resolution of which notice has not been given in accordance with the Articles may be passed.

Although resolutions of which notice has not been given cannot be passed at this meeting they may be dealt with under Sec. 65 (8) which provides—

65.—(8) The meeting may adjourn from time to time, and at any adjourned meeting any resolution of which notice has been given in accordance with the Articles, either before or subsequently to the former meeting, may be passed, and the adjourned meeting shall have the same powers as an original meeting.

The Statutory Meeting must be held by all companies limited by shares, whether they be public or private companies, and failure to hold it renders the company

liable to be wound up on the petition of any member after the expiration of fourteen days from the last date upon which the meeting should have been held.

The Statutory Report referred to in subsection (7) is required by subsection (2) of Sec. 65 to be sent by the directors to every member of the company, and to every other person entitled under the Act to receive it, at least seven days before the day on which the meeting is to be held.

The only persons other than members who would be entitled to receive this report are debenture and debenture stock holders who have, under Sec. 114 of the Act, the same right to receive reports as is possessed by ordinary shareholders in the company. Preference shareholders are also given this right under Sec. 114, but they are members of the company.

A private limited company, although it must hold a Statutory Meeting, is exempt by subsection (10) from forwarding or filing the Statutory Report.

Sec. 65 lays down the particulars that must be supplied in the Statutory Report, which briefly are—

(1) Full particulars of the allotment of shares and amounts paid up thereon.

(2) Receipts and payments on capital account. Revenue expenditure need not be included in this account. The capital receipts must distinguish between the amounts received in respect of shares or debentures.

(3) An account or estimate of preliminary expenses.

(4) Particulars of directors, auditors, managers, and secretary.

(5) Particulars of any contracts which are to be modified.

(6) A certificate signed by the auditors as to whether the report is correct or not so far as it relates to the shares allotted by the company, the cash received in

respect of such shares and to the receipts and payments on capital account.

The Statutory Report must also be certified by at least two directors, or by the sole director and manager, where there is only one director.

The following is a specimen form of such Statutory Report—

## THE COMPANIES (CONSOLIDATION) ACT, 1908

### REPORT

(Pursuant to Sec. 65 of the Companies (Consolidation) Act, 1908)  
of

### THE PUBLIC COMPANY, LIMITED

To be certified by not less than two Directors, or by the sole Director and Manager where there is only one, and forwarded at least seven days before the Statutory Meeting to every Member and Debenture Holder of the company, and to be filed with the Registrar of Companies forthwith after it is so forwarded.

(a) The total number of shares allotted is 90,000, of which 10,000 are allotted as fully paid up in consideration of (as per Purchase Agreement), and upon each of the remaining shares the sum of 5s. has been paid in cash.

(b) The total amount of cash received by the company in respect of the shares issued wholly for cash is £20,000.

(c) The Receipts and Payments of the company on Capital Account to 20th June, 1924, are as follows—

Particulars of Receipts.			Particulars of Payments.		
	£	s. d.		£	s. d.
To Amount Received on Application and Allotment of 80,000 shares	20,000	- -	By Preliminary Expenses	2,500	- -
			„ Investments . . .	10,000	- -
			„ Directors' Fees . .	250	- -
			„ Revenue Expenditure.	45	- -
			„ Balance on Deposit on Current Account at Glyn's Bank . . .	7,205	- -
	<u>£20,000</u>	- -		<u>£20,000</u>	- -

(d) The following is an account (or estimate) of the Preliminary Expenses of the company—

	£	s. d.
Estimated at . . . . .	3,500	- -

(e) Names, addresses, and descriptions of the directors, auditors (if any), managers (if any), and secretary of the company.

DIRECTORS			
Surname.	Christian Name.	Address.	Description.

  

AUDITORS			
Surname.	Christian Name.	Address.	Description.

  

MANAGERS			
Surname.	Christian Name.	Address.	Description.

  

SECRETARY			
Surname.	Christian Name.	Address.	Description.

(f) Particulars of any Contract the modification of which is to be submitted to the meeting for its approval, together with the particulars of the modification or proposed modification.

--

We hereby certify this Report

..  
 ..  
 .. } Directors.

We hereby certify that so much of this Report as relates to the shares allotted by the company and to the Cash Received in respect of such shares and to the Receipts and Payments on Capital Account is correct.

Auditors.

Dated the 21st day of January, 1925.

A copy of the Statutory Report, certified as required above, must be filed by the directors with the Registrar of Companies immediately after it has been sent to members of the company.

### **Annual General Meetings.**

Section 64 of the Act makes provision for the holding of Ordinary General Meetings as follows—

64.—(1) A general meeting of every company shall be held once at least in every calendar year, and not more than fifteen months after the holding of the last preceding general meeting, and, if not so held, the company and every director, manager, secretary, and other officer of the company who is knowingly a party to the default, shall be liable to a fine not exceeding fifty pounds.

(2) When default has been made in holding a meeting of the company in accordance with the provisions of this section, the Court may, on the application of any members of the company, call or direct the calling of a general meeting of the company.

The Articles usually provide for the calling of this meeting by the directors and, as a rule, require the directors to send with the notice of the meetings a report on the company's position for the year under review, together with a statement of accounts and auditor's report.

The Articles cannot, however, override the provision of Sec. 64 (1), and consequently the meeting must be held—

(1) Once in every calendar year, that is to say, between the 1st January and the 31st December; and

(2) Not more than fifteen months from the holding of the preceding general meeting.

The Statutory Meeting cannot be counted as an Ordinary General Meeting for these purposes.

The proceedings of the Annual General Meeting are usually commenced by the secretary reading the notice convening the meeting, but while this is usual, it is not essential; nevertheless as the custom of



reading such notices has been established, it may be as well, where the notice is not read, to put it to the meeting that it be taken as read.

The secretary will then usually proceed to read the minutes of the preceding meeting, but this also, although invariably done, is unnecessary unless the regulations of the company require them to be read.

The following business will then usually be dealt with—

(1) The auditor's report on the accounts must be read. This is usually done by the secretary.

(2) The directors' report and accounts, having been previously circulated amongst the shareholders, will usually be taken as read, when the chairman will proceed to deliver what is termed the "Chairman's Speech," which in the main deals with the report and accounts and sometimes expresses the sanguine hopes and beliefs of the directors. The adoption of the report and accounts will then be proposed and seconded and, after discussion by the shareholders, will be put to the meeting. The directors are not, however, bound to answer questions which they consider to be against the interests of the company. Shareholders should, however, refuse to pass the accounts if the auditor reports unfavourably, and the directors have no effective answer.

(3) To pass resolutions as to dividends.

(4) Re-election of retiring directors and re-election and remuneration of auditors. These re-elections should always be left to the shareholders' side of the table.

### **Extraordinary General Meetings.**

Any meeting, other than an ordinary general meeting, is termed an Extraordinary General Meeting, and may be summoned either by the directors at any time or as they may be required in accordance with Sec. 66

of the Act, or on their failure to do so, the majority of members required under that section may call the meeting.

Sec. 66 of the Act provides—

66.—(1) Notwithstanding anything in the Articles of a company, the directors of a company shall, on the requisition of the holders of not less than one-tenth of the issued share capital of the company upon which all calls or other sums then due have been paid, forthwith proceed to convene an extraordinary general meeting of the company.

(2) The requisition must state the objects of the meeting, and must be signed by the requisitionists and deposited at the registered office of the company, and may consist of several documents in like form, each signed by one or more requisitionists.

(3) If the directors do not proceed to cause a meeting to be held within twenty-one days from the date of the requisition being so deposited, the requisitionists, or a majority of them in value, may themselves convene the meeting, but any meeting so convened shall not be held after three months from the date of the deposit.

(4) If at any such meeting a resolution requiring confirmation at another meeting is passed, the directors shall forthwith convene a further extraordinary general meeting for the purpose of considering the resolution and, if thought fit, of confirming it as a special resolution; and, if the directors do not convene the meeting within seven days from the date of the passing of the first resolution, the requisitionists, or a majority of them in value, may themselves convene the meeting.

(5) Any meeting convened under this section by the requisitionists shall be convened in the same manner, as nearly as possible, as that in which meetings are to be convened by directors.

The requisition required under this section may consist of several documents of similar purport, even though they are not similar in all respects.

The Articles cannot deprive members of their rights under this section.

### **Special Meetings.**

Separate meetings of different classes of shareholders may be called for special purposes under the Act, as

under Secs. 45 and 120 ; these are dealt with in their proper places throughout this book. Such meetings are not, however, general meetings of the company, but are merely special meetings of particular classes of members.

### **Convening and Notice of Meetings.**

The Articles of the company will provide who is to convene meetings, and this matter is usually placed in the hands of the directors. The secretary has no power to convene the meetings on his own responsibility, but the directors may ratify the secretary's act by a board meeting held prior to the general meeting, in which case the meeting will be valid. Also where the secretary calls a meeting on the instructions of an irregularly constituted board, the resolutions passed at such meeting will be valid.

The directors should exercise their power to convene meetings by resolutions of the board duly recorded in the Minute Book.

It is the secretary's duty to see that meetings are properly convened and regularly held.

If the Articles do not make provision for the calling and giving notice of meetings, but not otherwise, the provisions of Sec. 67 of the Act apply as follows—

67. In default of, and subject to, any regulation in the Articles—

(1) A meeting of a company may be called by seven days' notice in writing, served on every member in manner in which notices are required to be served by Table "A" in the first schedule to this Act.

(2) Five members may call a meeting.

(3) Any person elected by the members present at a meeting may be chairman thereof.

(4) Every member shall have one vote.

Due notice of meetings must be given to all members entitled to receive it, in accordance with the terms of the Articles of the company. Seven clear days' notice

is usually required, and where the term "clear days" is used, neither the day of despatch of notice nor the day on which the meeting is held can be counted.

The time, date, and place of meeting is generally left by the Articles to the discretion of the directors.

The notice itself should clearly state the time, date, and place of and business to be dealt with at the meeting.

There is a tendency on the part of some directors, where questions are likely to be raised by shareholders which might be disconcerting, to fix a time and place for the holding of the meeting which is suitable to themselves and friendly shareholders, but is anything but convenient to the general body of shareholders. This must be labelled as a dishonest practice, as through it shareholders are deprived of a valuable check upon directors, especially where the press is properly represented.

The time and place of the meeting should, therefore, be fixed to suit the convenience of the shareholders generally, and not merely of a particular few.

If the Articles so provide, two meetings may be called by the same notice.

In most cases Articles usually provide that notices shall be served through the post, but sometimes notice by advertisement only is required. In either case notice must be given in the manner provided, for otherwise it will be bad.

Notices will be properly served if they are sent to the last known registered address of each member, unless the shareholder has requested notice to be delivered to him elsewhere, in which case the instruction should be given in writing.

Subject to the company's regulations all persons whose names are on the register are entitled to receive notice ; therefore, where a transfer has been executed

but not registered, notices will be properly served if sent to the transferor, and the transferee will not be entitled to receive a notice. If proper notice is not given to all shareholders in accordance with the Articles the proceedings of the meeting are invalid. In order, therefore, to safeguard the company against such cases the Articles usually contain a provision similar to clause 49 of Table "A," to the effect that the accidental omission to give any such notice shall not invalidate any resolution passed at such meeting.

In the absence of provision to the contrary in the regulations of the company notices need not be sent in the following cases—

(1) To members, resident abroad, who cannot be reached by post in sufficient time before the meeting. Where, however, the Articles require notice to be given to all members the notice must be sent to such members, but the Articles usually protect the company in such cases, by providing that the notice is to be deemed to be served on the day following that on which it is posted.

(2) To executors and administrators of a member, unless they themselves become registered as members, but the Articles may provide that notice is to be given to such.

(3) To shareholders who by the Articles are not entitled to attend the meetings. For example, in the case of preference shares which carry only a limited right for the holder to attend and vote at meetings, or where calls on shares are in arrear.

(4) In the case of an adjourned meeting, where it is adjourned to a fixed date, unless the Articles make special provision for notice, but where the meeting is adjourned *sine die* notice must be given.

The notices must reasonably specify the nature of the business of the meeting, as the company has no

power to pass resolutions outside the scope of the notice.

Invalid notices cannot be made valid even if every shareholder agrees, for this may amount to an alteration of the Articles without the passing of a special resolution.

## CONDUCT OF MEETINGS

### Quorum.

A quorum must be present before proceedings can commence. The Articles will fix the number of members necessary to form a quorum. The general rule of law is that it takes at least two to form a meeting, and if there are no provisions in the Articles, two members must be present, but there have been one or two exceptional cases (which may be left out of consideration) where one was considered sufficient. There must, of course, be an intention on the part of those present to form a meeting and the quorum must be present throughout the proceedings.

Unless the regulations of the company otherwise provide, the quorum must consist of members who are entitled to vote. Proxies cannot be counted as part of a quorum, as the members must be present personally, and joint holders of shares in the company must be counted as a single member.

It does not follow that the quorum necessary for a general meeting of the company is the same as that required for class meetings of shareholders, for the Articles may provide otherwise.

Where a state of affairs arises under which the number of members of the company sinks below the number required by the Articles to form a quorum, and in consequence it is impossible to obtain it, it has been held that the presence of all the members will constitute a quorum.

The Articles usually provide that if the requisite number of members is not present within a stated time, usually half an hour from the time appointed for the meeting, it may be adjourned to the same day in the next week at the same time and place, and if then a quorum cannot be obtained the members present shall form a quorum. Similar provisions to these are contained in Clause 52 of Table "A."

### **The Chairman.**

A meeting cannot act until someone properly appointed as chairman in accordance with the Articles has taken the chair.

The Articles generally provide that the chairman of the board of directors shall be the chairman of general meetings, or if he be not present within, say, fifteen minutes after the time appointed for holding the meeting, or is unwilling to act, then the members present can elect one of their number to be chairman. Sec. 67 of the Act gives the right, in the absence of provisions in the Articles, for any person elected by the members present at the meeting to act as chairman.

The chairman should be carefully chosen, as his duties require the exercise of a great deal of tact and diplomacy, and he may either make or mar a general meeting.

The duties and power of the chairman may be summarized thus—

(1) He must have proper regard to the regulations of the company as to the conduct of meetings.

(2) To preserve order. Where there is persistent disorder he should adjourn the meeting for either a long or a short period as he may deem expedient, e.g. for a week or to a later hour on the same day.

(3) He must see that a fair hearing is given to the

minority. He should in this respect regulate the speaking and afford protection to the speakers from interruption.

(4) He must decide on questions of order with strict impartiality, and conduct the proceedings in a proper manner.

(5) He must see that business dealt with comes within the scope of the notice of the meeting.

(6) He may apply the closure with the consent of the meeting, and put the question under discussion to the meeting.

(7) He may adjourn the meeting, but he must exercise this power in the interests of the company, and not in the interests of particular members. He is not, however, bound to adjourn the meeting, in the absence of provisions to the contrary in the Articles, even where a majority of members present request him to do so.

(8) To declare the result of any poll that may be taken on proper demand.

The chairman will usually have present at general meetings as his advisers, the solicitor, secretary, and auditor of the company.

The chairman has no right to a casting vote unless the regulations of the company give him one. Where the regulations do so give him a casting vote he is not bound to use it.

## VOTING

### Voting Powers.

The rights of the shareholders as to voting powers will be fixed by the Articles, but in the absence of such provisions Sec. 67 (4) of the Act applies, under which every member is entitled to one vote.

It has been already observed in this book that the voting powers of different classes of shareholders



depend in no way upon the nominal value of the respective shares of each class and that preference shareholders are very often given only a limited right to vote on certain questions.

Where a company is a member of another company Sec. 68 of the Act provides—

68. A company which is a member of another company may, by resolution of the directors, authorize any of its officials or any other person to act as its representative at any meeting of that other company, and the person so authorized shall be entitled to exercise the same powers on behalf of the company which he represents as if he were an individual shareholder of that company.

### **Methods of Voting.**

Voting, in the first instance, is by a show of hands and, in the absence of any demand for a poll, the chairman's declaration as to the result of such voting is conclusive except where there is fraud or an obvious mistake. On a show of hands each member has only one vote.

A director may vote at general meetings on any matter upon which he may be precluded from voting at board meetings, e.g. on contracts in which he is interested, for at general meetings he votes as a shareholder and not as a director.

It has already been stated that a chairman has no casting vote unless the Articles give him one.

Proxies cannot be used on a vote by a show of hands.

There is a common law right to demand a poll, but this may be negatived by the regulations of the company.

The poll must be demanded in the proper manner laid down by the Articles, and should be demanded immediately after the result of the voting by a show of hands has been declared. The chairman cannot refuse a poll properly demanded, and he must fix time

and place for taking the poll, which must be taken in the manner prescribed by the Articles.

Sec. 69 (4) of the Act gives a statutory right to demand a poll in certain cases as follows—

69.—(4) At any meeting at which an extraordinary resolution is submitted to be passed or a special resolution is submitted to be passed or confirmed a poll may be demanded, if demanded by three persons for the time being entitled according to the Articles to vote, unless the Articles of the company require a demand by such number of such persons, not in any case exceeding five, as may be specified in the Articles.

It will depend on the Articles as to whether the demand is to be made orally or in writing. In most Articles, however, it is provided that a poll shall be demanded either in writing signed by five members entitled to vote or orally by the chairman of the meeting.

The length of time the poll may be kept open is usually left to the discretion of the chairman, and at any time before he declares the poll closed members may come in and vote, even though they were not present at the meeting at which it was demanded.

The majority will be calculated in accordance with the number of votes conferred on each share by the Articles, so that while the member will have only one vote on a show of hands he may have one vote in respect of each share he holds on a poll.

Scrutineers are generally required to be appointed under the terms of the Articles of the company, to vouch for the correctness or otherwise of the poll.

Where there are several resolutions, upon which a poll has been demanded, they must be put to the poll separately and not altogether.

The wrongful exclusion of any member will invalidate the poll.

On a poll the votes may, usually, be given either personally or by proxy.

**Proxies.**

Proxies are of two kinds, namely, general and special.

A general proxy gives power to vote on all matters arising at any meeting or any adjournment thereof, and requires a ten shilling stamp.

A special proxy merely gives a power to vote on certain specified matters at a specified meeting or its adjournment, and requires only a penny stamp.

The form of these proxies will be fixed by the Articles of the company.

There is no Common Law right to vote by proxy and, therefore, before proxies can be used there must be an express provision to that effect in the Articles of the company. Where, however, the Articles allow the vote to be exercised in this manner any one or more of the following conditions may apply, as may be decided by the Articles—

(1) That the instrument of proxy shall be in form specified by the Articles, and shall be left with the company a specified number of hours before the meeting.

(2) That only members entitled to vote may give a proxy.

(3) That the person appointed as proxy shall be a member of the company.

In all of these cases the provisions must be strictly complied with in order to render the proxy valid.

Alternative persons may be appointed to act in order to ensure the proxy being used.

Proxies lodged after the expiration of the time fixed by the Articles for such lodgment cannot be used either for the meeting in respect of which they are lodged or for any adjournment thereof. The Articles may, however, provide that proxies lodged after the meeting may be used at an adjournment thereof, but otherwise such proxies are invalid.

A proxy may be revoked in any of the following ways—

(1) By the attendance of the appointer at the meeting.

(2) By a subsequent proxy given in time to be deposited with the company as required by the Articles.

(3) By death of the appointer.

(4) By written notice to the company withdrawing the instrument of proxy.

### RESOLUTIONS

Resolutions may be divided into four classes—

(1) Ordinary resolutions.

(2) Extraordinary resolutions.

(3) Special resolutions.

(4) Other resolutions.

#### **Ordinary Resolutions.**

Ordinary resolutions are those which are passed by a simple numerical majority of members present personally or by proxy (where proxies are allowed) at a meeting at which the subject matter of the resolution is proposed.

Ordinary resolutions are generally used for the transaction of the ordinary annual matters of business, e.g. passing the accounts. Only one meeting is necessary to pass an ordinary resolution.

#### **Extraordinary Resolutions.**

Extraordinary resolutions are those which are passed in the manner required by Sec. 69 of the Act, which provides as follows—

69.—(1) A resolution shall be an extraordinary resolution when it has been passed by a majority of not less than three-fourths of such members entitled to vote as are present in person or by proxy (where proxies are allowed) at a general meeting of which notice specifying the intention to propose the resolution as an extraordinary resolution has been given.

Only one meeting, therefore, is required for the purpose of passing an extraordinary resolution, but there are three essentials to the validity of the resolution—

(1) The notice calling the meeting must specify the intention to propose the resolution as an extraordinary resolution; and

(2) It must be passed by a three-fourths majority. A bare majority is ineffective.

(3) The notice must be given and the meeting held in manner provided by the Articles of the company.

Subsection (3) of Sec. 69 provides that where a poll is not demanded the declaration of the chairman that the resolution is carried is conclusive evidence of the fact without proof of the number or proportion of the votes recorded for or against the resolution.

An extraordinary resolution may be required for any purpose the persons responsible for the framing of the company's Articles think expedient, except where the Act provides specifically for any other form of resolution, but the Act makes special provision for an extraordinary resolution in the following cases—

(1) Under Sec. 182 for the purposes of winding-up the company voluntarily where the reason for winding-up is that it cannot meet its liabilities.

(2) Under Sec. 190 to delegate the power of appointing a liquidator or liquidators to the creditors of the company.

(3) Under Sec. 191 to sanction arrangements with creditors when the company is in voluntary liquidation.

(4) Under Sec. 214 to effect compromises with creditors and others.

Under Table "A" an extraordinary resolution is required to increase the company's capital, but this Table is rarely adopted by companies in which case

their own Articles may provide for an ordinary resolution or it may be left to the directors.

A copy of every extraordinary resolution must be printed and filed with the Registrar of Companies within fifteen days of its being passed.

### **Special Resolutions.**

A Special Resolution, as defined by Sec. 69 (4) of the Act, is one which has been—

(1) Passed in manner required for the passing of an extraordinary resolution ; and

(2) Confirmed by a majority of such members entitled to vote as are present personally or by proxy (where proxies are allowed) at a subsequent general meeting, of which notice has been duly given, and held after an interval of not less than fourteen days, nor more than one month, from the date of the first meeting.

Two meetings are therefore necessary in this case, but they may both be convened by the same notice if the Articles so provide.

The first part of a special resolution is not an extraordinary resolution, as is sometimes stated, but is required to be passed only in the manner required for passing an extraordinary resolution ; that is to say, by not less than a three-fourths majority of the members entitled to vote and who are present personally or by proxy (where proxies are allowed by the Articles) at the meeting. To make such a resolution an extraordinary resolution notice specifying the intention to propose the resolution as such must also have been given.

The passing of the first part of a special resolution is not effective until it has been confirmed at the subsequent meeting required to be held for that purpose, and as this meeting cannot, in any case, be held sooner than fourteen days after the date of the

first meeting, shareholders thus have a further opportunity of thinking the matter over again and facts may come to light in the interim which may decide them not to confirm the first part of the resolution, in which case it will fall to the ground.

The shareholders cannot, however, at the confirmatory meeting vary the resolution as passed at the first meeting; they must either confirm or reject the resolution as it stands.

Unless a specified form of resolution is decreed by the Act for any particular purposes, the Articles of the company may provide a special resolution for any matter the promoter or the subscribers to the Memorandum may deem expedient.

The Act, however, provides for a special resolution in the following cases—

(1) Under Sec. 8 to change the name of the company with the written consent of the Board of Trade.

(2) Under Sec. 9 to alter the Memorandum of the company in respect to its objects with the subsequent sanction of the Court.

(3) Under Sec. 13 to make any alteration in the Articles of the company.

(4) Under Sec. 41 to increase the capital of the company where no power is contained in the Articles. If, however, the Articles so provide an ordinary, extraordinary, or a special resolution may be necessary and Table "A" provides for this increase to be made by extraordinary resolution.

(5) Under Sec. 41 to subdivide the existing share capital of the company.

(6) Under Sec. 41 to convert the share capital of the company into stock or reconvert the stock into shares.

(7) Under Sec. 45 to reorganize the share capital of the company with regard to different classes of

shares, with the sanction of another resolution, which is not a special, ordinary, or extraordinary resolution, of the classes affected by the reorganization.

(8) Under Sec. 46 to reduce or cancel paid up share capital. Two special resolutions will be necessary if the Articles do not contain power so to reduce the capital. The scheme for reducing the capital must then be sanctioned by the Court after it is passed.

(9) Under Sec. 59 to resolve that a certain part or the whole of any uncalled capital shall not be capable of being called up except in the event of and for the purposes of winding-up.

(10) Under Sec. 110 to appoint inspectors to investigate the affairs of the company.

(11) Under Sec. 121 a special resolution is required for the purpose of converting a private limited company into a public limited company, in addition to which a statement in lieu of prospectus must be filed.

(12) Under Sec. 129 to resolve that the company be wound up by the Court.

(13) Under Sec. 182 to resolve that the company be wound up voluntarily, but if it is being wound up voluntarily because of its liabilities an extraordinary resolution is required, and if it is being wound up voluntarily by reason of the fulfilment of its object or expiration of time as fixed by the Articles, an ordinary resolution is all that is necessary.

(14) Under Sec. 192 to reconstruct the company.

Provisions are made in Sec. 70 for filing extraordinary and special resolutions, and for the embodying of all special resolutions in the Articles of the company.

The provisions of Sec. 70 are as follows—

70.—(1) A copy of every special and extraordinary resolution shall within fifteen days from the confirmation of the special resolution, or from the passing of the extraordinary resolution, as the case may be, be printed and forwarded to the Registrar of Companies, who shall record the same.



(2) Where Articles have been registered, a copy of every special resolution for the time being in force shall be embodied in or annexed to every copy of the Articles issued after the confirmation of the resolution.

(3) Where Articles have not been registered, a copy of every special resolution shall be forwarded in print to any member at his request, on payment of one shilling or such less sum as the company may direct.

(4) If a company makes default in printing or forwarding a copy of a special or extraordinary resolution to the registrar it shall be liable to a fine not exceeding two pounds for every day during which the default continues.

(5) If a company makes default in embodying in or annexing to a copy of its Articles or in forwarding in print to a member when required by this section a copy of a special resolution, it shall be liable to a fine not exceeding one pound for each copy in respect of which default is made.

(6) Every director and manager of a company who knowingly and wilfully authorizes or permits any default by the company in complying with the requirements of this section shall be liable to the like penalty as is imposed by this section on the company for that default.

### **Other Resolutions.**

Other forms of resolutions may be provided in the company's Articles for any special purpose the company thinks expedient, e.g. that a two-thirds majority be required for any special purpose, but where a defined resolution is required by the Act for any particular purpose it must be adhered to.

Other resolutions under the Act which cannot be classified as Ordinary, Extraordinary, or Special resolutions, are as follows—

(1) Under Sec. 45 two meetings of any classes of shareholders who are affected by a scheme of reorganization of share capital must be held, one meeting to pass the resolution required by that section by a majority in number of the members of each separate class affected, holding three-fourths of the share capital of that class, and the other meeting to confirm such resolution in the same manner as a special resolution is confirmed.

(2) Under Sec. 120 to effect a compromise or arrangement with members or a class of members a majority in number representing three-fourths in value of the members present personally or by proxy at the meeting is required, but in this case the sanction of the Court must be obtained to hold the meeting, and also subsequently when the resolution is passed, it must be sanctioned by the Court.

### **Right of Shareholders as to Investigations.**

Where shareholders are dissatisfied as to the conduct of the affairs of the company, as revealed by the proceedings at meetings and the directors' reports and accounts, although they cannot over-ride the powers vested in the directors by the Articles without first altering those Articles by special resolution, and cannot force the directors to give information which they are of opinion might damage the company, yet the shareholders are not entirely without a means of obtaining the information they desire, for the following courses are open to them—

(1) To refuse to pass the accounts and appoint a committee of shareholders to consider with the directors some matter arising out of any discussion at the meeting or on the report and accounts submitted to the meeting, and make a report to the shareholders at an adjourned meeting.

This method can be fruitful only where the directors themselves have nothing to hide, and are in sympathy with the investigating committee, for there is no power given to such committee to inspect the books or examine witnesses on oath.

For these reasons this course is usually adopted only on the suggestion of the directors to investigate matters which are not serious enough to upset absolutely the confidence of the shareholders in the directors.

Where, however, the directors refuse to accept the appointment of such a committee, or do not provide proper facilities for the conduct of the investigation by such committee, or the matters to be investigated are of a more serious character, the shareholders may adopt either of the two statutory methods of investigation dealt with below.

(2) Sec. 109 of the Act provides a means of investigation by inspectors who are appointed by the Board of Trade to carry out an investigation on behalf of shareholders on the application of members holding a specified proportion of the issued share capital, such proportion being one-third in the case of banking companies, and one-tenth in the case of other companies having a share capital.

This is the strongest weapon in the hands of the shareholders, for by it the directors, officers, and agents of the company may be made to produce to the inspectors all books and documents in their custody or power, and may be examined on oath in relation to the business of the company. It is doubtful, however, whether persons who have ceased, before the inspection commences, to be directors, agents, and officers of the company can be called upon. It is regrettable that the section is not made to apply specifically to present and past directors, agents, and officers.

The inspectors thus appointed will make their report to the Board of Trade in such form as it may direct, and one copy of the report will be sent by the Board of Trade to the registered office of the company, and another copy will, on request being made by the applicants for the investigation, be delivered to them.

The provisions of Sec. 109 are as follows—

109.—(1) The Board of Trade may appoint one or more

competent inspectors to investigate the affairs of any company, and to report thereon in such manner as the Board direct—

(i) In the case of a banking company having a share capital, on the application of members holding not less than one-third of the shares issued :

(ii) In the case of any other company having a share capital, on the application of members holding not less than one-tenth of the shares issued :

(iii) In the case of a company not having a share capital, on the application of not less than one-fifth in number of the persons on the company's register of members.

(2) The application shall be supported by such evidence as the Board of Trade may require for the purpose of showing that the applicants have good reason for, and are not actuated by malicious motives in requiring, the investigation ; and the Board of Trade may, before appointing an inspector, require the applicants to give security for payment of the costs of the inquiry.

(3) It shall be the duty of all officers and agents of the company to produce to the inspectors all books and documents in their custody and power.

(4) An inspector may examine on oath the officers and agents of the company in relation to its business, and may administer an oath accordingly.

(5) If any officer or agent refuses to produce any book or document which under this section it is his duty to produce, or to answer any questions relating to the affairs of the company, he shall be liable to a fine not exceeding five pounds in respect of each offence.

(6) On the conclusion of the investigation the inspectors shall report their opinion to the Board of Trade, and a copy of the report shall be forwarded by the Board to the registered office of the company, and a further copy shall, at the request of the applicants for the investigation, be delivered to them.

The report shall be written or printed, as the Board direct.

(7) All expenses of and incidental to the investigation shall be defrayed by the applicants, unless the Board of Trade direct that they be paid by the company, which the Board is hereby authorized to do.

(3) The other statutory method of investigation is provided by Sec. 110 of the Act, under the provisions of which the company may make the appointment of inspectors without having recourse to the Board of Trade.

The appointment of the inspectors must, however,

be made by special resolution of the company. They will make their report direct to the company and not through the Board of Trade, as in the case of inspectors appointed under Sec. 109.

The inspectors appointed by the company under Sec. 110 have the same powers as those appointed by the Board of Trade. For this reason, the Board of Trade is rarely required to make the appointment.

Sec. 110 of the Act provides—

110.—(1) A company may by special resolution appoint inspectors to investigate its affairs.

(2) Inspectors so appointed shall have the same powers and duties as inspectors appointed by the Board of Trade, except that, instead of reporting to the Board, they shall report in such manner and to such persons as the company in general meeting may direct.

(3) Officers and agents of the company shall incur the like penalties in case of refusal to produce any book or document required to be produced to inspectors so appointed, or to answer any question, as they would have incurred if the inspectors had been appointed by the Board of Trade.

## CHAPTER XIII

### THE STOCK EXCHANGE IN RELATION TO THE COMPANY AND THE INVESTOR

IT may be stated at the outset that it is not the intention of this chapter to deal fully with the internal arrangements of the Stock Exchange, but merely to indicate its functions in relation to the company and the members of the outside world.

#### **The Constitution of the Stock Exchange.**

The Stock Exchange is the recognized market for the purchase and sale of shares and securities of public concerns. It is divided into many sub-markets such as the Consols Market, which deals with gilt-edged securities, the Mining Market, which deals with the shares, etc., of mining companies, the Industrial Market, Rubber Market, Oil Market, and many others. It will therefore depend upon the nature of the company's business as to which market the shares will be dealt in.

The members of the Stock Exchange are governed by the rules of that body, and are divided into two classes, namely, Jobbers, who always act as principals and with whom the company or the investor rarely comes into contact, and Brokers, who act as agents, dealing with the jobbers on behalf of their principals who are the members of the outside world.

Jobbers never act as agents, but brokers may buy and sell as principals on their own account, but if they are dealing with the securities of their clients or selling their own securities to clients, the rule of agency applies as to secret profits, and they must first obtain

their client's permission to deal as a principal, otherwise they may be making a secret profit out of their agency, which they may be made to refund to the principal. Members cannot act as both jobbers and brokers.

The management of the Stock Exchange is in the hands of a committee, which is elected annually by the members. It is to this committee that all disputes between members are referred.

A member who cannot meet his obligations is "hammered," that is to say, an official of the Stock Exchange hammers the table to call the attention of the members in the "House" to an announcement he has to make, by which such member is declared a defaulter. The debts due from the delinquent to other members of the Stock Exchange are then claimed from the Official Assignee at hammer prices, that is, the price to which the securities are made up immediately prior to the hammering of the defaulting member. Debts due from other members are also dealt with in a similar manner, and are paid to the Official Assignee at hammer prices.

The Official Assignee takes an equitable assignment of the debtor's property for the benefit of the creditors of the Stock Exchange, but he cannot proceed to distribute the assets until the expiration of three months, for the assignment is an "Act of Bankruptcy," and consequently, as the rights of the members of the outside world are not affected by the internal arrangements of the Stock Exchange, a bankruptcy petition may be founded upon it by any outside person or persons to whom the delinquent may be in debt to the extent of £50.

Two Official Assignees are appointed by the Stock Exchange committee annually; one is called the Official Assignee and the other the Deputy Official Assignee. They must both find security amounting to

£1,000 from two or more members of the Stock Exchange.

The term "securities" is somewhat loosely used on the Stock Exchange, as it includes not only securities for the repayment of moneys, but also shares and stock which, strictly speaking, are not securities. This Stock Exchange interpretation has, however, been used throughout this book.

The method of dealing on the Stock Exchange is described later in this chapter.

It will be seen later that the Stock Exchange exercises a beneficial influence on limited companies, as its rules are very stringent and must be strictly adhered to.

### **The Stock Exchange and the Company.**

It is the ambition of every well conducted company to obtain from the Stock Exchange—

(1) Permission for its shares, etc., to be dealt in on the Stock Exchange; and

(2) An official quotation of its shares, etc., in the official list published daily by the Share and Loan Department of the Stock Exchange.

The more active the market, the more demand there is for the shares of the company, and it is a very difficult matter to create a market outside the Stock Exchange which will provide the facilities afforded by that body. There are, however, cases where markets are created outside the Stock Exchange, as will be observed by the lists of securities advertised for sale or purchase in the financial press by outside stock and share brokers. In most of these cases, however, the prices advertised do not compare favourably with the prices current on the Stock Exchange.

Sometimes directors of companies or large shareholders therein endeavour to, what is termed, "rig the market" in the company's shares; that is to say,



an agreement is made with one or more jobbers under which the jobbers will be given the right to call for a certain number of issued shares at a fixed price, and the persons owning the shares will, at the same time, undertake to give orders to brokers to buy the shares in the market at or over the price fixed with the jobbers.

These transactions resolve themselves into a series of sales and purchases on behalf of the same individual until sufficient interest is aroused on the part of the investing public, when the market will commence to function in a normal manner.

This process of rigging is generally helped by the publication of the Stock Exchange tape prices, market reports, and articles or telegrams written or sent specially for publication in the financial press.

It is to the advantage of the jobber to raise the price as high as possible, for usually the difference between the price fixed at which he is entitled to call for the shares and the price realized for them goes to him.

This process of rigging a market can be justified only where the price to which the shares are raised represents their intrinsic worth, for where this is not so, it will not take long for the bottom to fall out of the market, in which case someone other than the original owner will be left to "nurse the baby."

It therefore behoves the investor to ascertain, if possible, the reason for any rapid rise in price or increase in the number of dealings in the shares of any particular concern to which he may be attracted by reason of such activity, remembering at the same time that the common inclination of investors to buy on a rising market is often taken advantage of, by the method outlined above, by unscrupulous persons who wish to unload a block of shares they have little desire to keep.

So soon as the company has made a new issue of its shares or securities it should, in the interests of its members, apply through its broker to the Committee of the Stock Exchange for permission to deal in them and for an official quotation of the shares. The rules of the London Stock Exchange with regard to these matters are printed, with the permission of the Committee of the Stock Exchange, at the end of this chapter.

## THE STOCK EXCHANGE AND THE INVESTOR

### **Methods of Purchasing or Selling Shares, Etc.**

It is strange but true that secretaries of companies are frequently asked by shareholders or debenture holders how they can sell their shares or debentures.

Investors may realize the shares or securities held by them, or make a purchase of shares or debentures in any of the following ways—

- (1) By private contract ;
- (2) By instructing their bankers to make the purchase or sale ; or
- (3) By getting into direct touch with the broker who is a member of the Stock Exchange ;
- (4) By dealing through a broker who is not a member of the London or Provincial Stock Exchanges. This method is left out of consideration, as it is not recommended.

In the first case the commissions payable to brokers would be avoided. In the second case the bank would instruct their broker to buy or sell, as the case may be, sharing half the commission received by him. In the third case, the broker will receive the full amount of commission, and for this reason alone he is likely to take a greater interest in the deal than is the case where he has to share his commission with someone else.

Under the new rule of the Stock Exchange only one commission will be payable, at the option of the broker, where the securities are bought and sold in the same account, or where they are bought in one account and sold in the next succeeding account.

The minimum scale of commissions allowed by the Stock Exchange rules to be charged to clients by brokers is as follows—

Securities of or Guaranteed by the British or Indian Government having a currency of not more than twelve years, in bargains of not less than £20,000 Stock	}	$\frac{1}{8}$ per cent on Stock

Consols, $2\frac{3}{4}\%$ and $2\frac{1}{2}\%$ Annuities	$\frac{1}{16}$ „ „ Stock
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Other British Government Securities, Indian Government Stocks, Metropolitan Con- solidated Stocks, London County Con- solidated Stocks, Colonial Government Se- curities, County, Corporation, and Pro- vincial Securities (British, Indian or Colonial)	}	$\frac{1}{4}$ „ „ Stock

Bank of England and Bank of Ireland Stock	$\frac{1}{4}$ „ „ Money
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Foreign Government and Corporation Bonds.	}	At discretion.
Price 1 or under . . . . .		

Foreign Government and Corporation Bonds.	}	$\frac{1}{32}$ per cent on Stock
Price 5 or under . . . . .		

Foreign Government and Corporation Bonds	}	$\frac{1}{16}$ „ „ Stock
Price 10 or under . . . . .		

Foreign Government and Corporation Bonds.	}	$\frac{1}{8}$ „ „ Stock
Price 20 or under . . . . .		
Foreign Railway and other Bonds to Bearer.	}	
Price 20 or under . . . . .		

Foreign Government and Corporation Bonds.	}	$\frac{1}{4}$ „ „ Stock
Price over 20 . . . . .		
Foreign Railway and other Bonds to bearer	}	
Price over 20 . . . . .		

Registered Stocks . . . . .	$\frac{1}{2}$ „ „ Money
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Shares, Registered or Bearer (other than shares of \$50 or \$100 denomination) dealt in in the American Market.

	£	s.	d.	£	s.	d.	s.	d.
Price	1	—	or under	.	.	.	At discretion	
Over	1	—	to	2	—	.	$\frac{1}{2}$	per Share
"	2	—	to	3	6	.	$\frac{1}{4}$	"
"	3	6	to	5	—	.	1	"
"	5	—	to	15	—	.	$1\frac{1}{2}$	"
"	15	—	to	1	10	—	3	"
"	1	10	—	2	—	—	$4\frac{1}{2}$	"
"	2	—	—	3	—	—	6	"
"	3	—	—	4	—	—	$7\frac{1}{2}$	"
"	4	—	—	5	—	—	9	"
"	5	—	—	7	10	—	1	0
"	7	10	—	10	—	—	1	3
"	10	—	—	15	—	—	1	6
"	15	—	—	20	—	—	2	—
"	20	—	—	25	—	—	2	6
"	25	—	—	.	.	.	$\frac{1}{2}$	per cent on Money

Shares of \$50 or \$100 Denomination dealt in in the American Market

Price \$5 or under	.	.	.	.	.	At discretion	
						s. d.	
Over \$5 to \$25	.	.	.	.	.	6	per share
" \$25 to \$50	.	.	.	.	.	9	"
" \$50 to \$100	.	.	.	.	.	1	—
" \$100 to \$150	.	.	.	.	.	1	6
" \$150 to \$200	.	.	.	.	.	2	—

With 6d. rise for every \$50, or portion thereof, in price.

Options for more than one Account . . . . . As on bargains

Options for one Account or less	.	.	.	.	.	} At discretion
Bargains in Partly-paid Stock or Shares of New Issues	.	.	.	.	.	
Bargains in Rights for Cash	.	.	.	.	.	
Powers of Attorney for Inscribed Stock	.	.	.	.	.	
Probate and other Valuations	.	.	.	.	.	
Securities made up or made down	.	.	.	.	.	
Short-dated Securities (having five years or less to run)	.	.	.	.	.	
Transfer of Stocks and Shares	.	.	.	.	.	

SMALL BARGAINS. No lower commission than £1 to be charged except in the case of—

(a) Transactions amounting to less than £100 in value on which a commission of not less than 10s. must be charged ; or

(b) Transactions amounting to less than £20 in value on which a commission of not less than 5s. must be charged.

## Method of Dealing on the Stock Exchange.

The method of dealing on the Stock Exchange is as follows—

(1) The investor will instruct his broker to buy or

sell a stipulated number of shares or amount of stock, or he may first ask his broker for a price, without intimating whether he is a seller or a buyer, and give his instructions after receiving such price.

(2) The broker will get into touch with a jobber in the particular market concerned, and ask him to make a price for the shares, stock, or debentures. The broker will not, or should not, however, in the first instance, tell the jobber whether he is a buyer or seller, although as will be seen later, the jobber has a way of finding this out for himself.

The jobber is not bound to make a price, but if he does not do so he will lose his clientele, as there will be several jobbers in the same market who are in competition with each other.

The jobber will then give the broker two prices, e.g. 20s., 20s. 6d.; the first price is the figure per share at which he is prepared to buy, and the second price is the figure at which he is prepared to sell. The difference between these two prices is termed the "Jobber's turn," and represents the fund from which he derives his profit. If the jobber does not want to buy or sell he will widen his price accordingly, e.g. if he does not want to buy he may quote 18s. 6d., 20s. 6d., and if he is not a seller he would quote 20s., 22s. By this process of widening the price the jobber can generally find out whether the broker is a buyer or seller, for if the broker does not like the first price quoted, and the jobber widens it the wrong way, the former will still be dissatisfied, which will immediately indicate the position to the jobber.

On being satisfied with the price the broker will carry out the instructions of his client, and buy or sell accordingly. On completion of the transaction the jobber and broker will record it in their respective bargain books. The jobber in turn will then

effect an opposite contract with another jobber or broker.

(3) The same evening the brokers will post to their respective clients either a bought or a sold contract note, as the case may be, giving details of the contract entered into. The client or the broker will not at present be called upon to settle the transaction, and the shares will probably have been dealt in over and over again before a settlement is required.

(4) In due course a transfer in the form required by the particular company's Articles which, under Stock Exchange rules, must be in common form, will be prepared by the broker and sent to his client for signature if such client be a seller. The transfer will then be returned to the broker, together with the certificate, when the process of certification described on page 269 will take place.

The seller may notice, on receipt of the transfer for signature, that the consideration for sale stated therein differs from the consideration shown on his contract note; this apparent discrepancy is due to sub-sales made after his broker effected the original sale on his behalf. The name of the last person to buy the shares is inserted as transferee.

The investor may require his broker to mark the deal, that is, record the price at which the deal was effected on a slip of paper, and drop it into a box kept for that purpose in the Stock Exchange. The investor can then check the price as per his contract note with these markings, which are recorded in the financial columns of the daily press on the succeeding day.

(5) When the name of the buyer has been passed to the selling broker, which is done on what is known as Name or Ticket Day, the certified transfer will be sent to the transferee's broker, who will obtain the signature of the transferee thereon, and present

the transfer at the company's transfer office for registration.

(6) All contracts for sale or purchase are made for settlement on a fixed day, but in the case of a new issue a special settlement may have been granted. Settlements are effected on the Stock Exchange fortnightly, and all transactions are entered into for the fortnightly account unless otherwise stipulated for. Arrangements can, however, usually be made to "carry over" the deal to the next account, in consideration of the payment to the seller by the buyer of a rate of interest termed "contango rate" or the payment of interest to the buyer by the seller termed "backwardation." Which of these forms of interest will be payable depends upon whether the "bulls" or "bears" predominate in the market. "Bulls" are persons who buy shares, etc., in the hope that the price will rise sufficiently during the account for them to sell at a profit, such persons having no intention of taking up the purchase. "Bears" are those people who sell what they either do not possess or do not intend parting with, in the hope that the price will fall, during the account, to a figure at which they can buy and deliver at a profit.

During the War, and until recently, these contango dealings were not allowed, as all deals were required to be for cash only.

(7) Investors who desire to limit their loss in connection with the purchase or sale of shares, etc., may do so by making such purchase or sale under an "option" purchased on the Stock Exchange.

### Options.

These options are three in number—

(1) "Call options," under the purchase of which the investor or speculator, as the case may be, acquires

the right to purchase certain shares, stock or debentures, on a given future date at a fixed price, in consideration of the payment of a fixed sum for the purchase of the option.

(2) "Put Options," under the purchase of which the investor acquires the right to deliver shares, etc., on a given future date at a fixed price for a similar consideration as required for "call options."

(3) "Put and Call Options," or, as they are also described, "Double Options," under the purchase of which the investor has the right to acquire or deliver the shares, etc. In other words he backs it both ways.

In all these cases the investor is not bound to exercise his option, but if he does not do so his loss will be limited to what is termed the "option money," that is the amount he has paid for the option.

## RULES OF THE STOCK EXCHANGE

### Permission to Deal in New Issues.

(a) The following documents and particulars should be sent to the Secretary of the Share and Loan Department when application is made for permission to deal—

(1) Certificate of Incorporation (in the case of a company registered abroad notarially certified copy or translation of Certificate of Incorporation and of By-laws).

(2) Copy of Resolutions authorizing issue.

(3) Certified Copy of Agreement relating to issue of shares credited as fully-paid and of any other contracts mentioned in prospectus.

(4) In the case of an issue for cash, copy of Prospectus, Offer for Sale or Circular of issue, stating all material conditions relating to the flotation of the Issue, and (in the case of a new company) to the formation of the company and endorsed with the date of advertisement if publicly advertised.

(5) If issued *pro rata* to existing shareholders, undertaking to split letters of renunciation.

(6) Specimen (or advance proof) of Allotment Letter, and, if possible, of Definitive Certificates. In order to facilitate the certification of transfers it is suggested that the Allotment Letter should contain the distinctive numbers of the shares to which they relate.

(7) Letter (a) giving distinctive numbers of shares issued, (b) undertaking to issue all the Allotment Letters simultaneously and



to certify transfers against Allotment Letters, and (c) stating (in the case of a further issue) whether or not the shares are identical in all respects with existing shares.

(8) Approximate date when definitive Certificates will be ready for issue.

(9) In all issues other than Government or Municipal Loans, whether by Prospectus or otherwise, particulars of any underwriting must be disclosed, and copy of underwriting Agreement, and of sub-underwriting letter, if any, must be produced.

(10) In case of a Debenture issue, copy or draft of Trust Deed.

(11) List of allottees or present holders—name, address and holding (when required).

(b) In the absence of any Prospectus publicly advertised in this country, or circular to shareholders, the Committee will also require an advertisement in two leading London morning papers giving all material conditions relating to the formation of the company and to the flotation of the issue, and stating that the directors collectively and individually are responsible for the information advertised.

These details must also include official statements as to—

(1) The capital, authorized and issued.

(2) Borrowing powers and the extent to which they have been exercised.

(3) Date and particulars of incorporation.

(4) Names and addresses of directors, bankers, auditors, and secretary.

(5) Objects of the company, nature of its business or particulars of property acquired.

(c) Where a broker is instructed to sell on behalf of a company a further issue of stock or shares forming a part of an amount previously created (permission to deal, if necessary, having been given for the original issue) he may obtain permission to deal on presentation of a letter from the company authorizing him to make the sale, or he may sell the stock or shares previous to permission being given, provided he makes the sale subject to the permission being granted.

(d) In the case of securities of a purely local nature within Great Britain or Northern Ireland or of a Colonial or Foreign issue of which no former security has been

quoted previously on a Colonial or Foreign Exchange, a broker may make a specific bargain with the authority of the Chairman or the Deputy-Chairman or two members of the Sub-Committee on New Issues and Official Quotations, but bargains shall not be recorded in the Supplementary List until permission to deal in the issue has been granted by the Committee.

(e) In the case of securities quoted on a Colonial or Foreign Exchange or in the case of new issues where a previous issue or issues of the same country, corporation or company have been quoted on a Colonial or Foreign Exchange a broker may make a specific bargain, but bargains shall not be recorded in the Supplementary List until permission to deal in the issue has been granted by the Committee.

### **Official Quotations.**

(a) CONDITIONS PRECEDENT TO AN APPLICATION  
FOR OFFICIAL QUOTATION  
(Rules 162 and 163)

(1) That the Prospectus—

Shall have been publicly advertised ;

Agrees substantially with the Act of Parliament or Articles of Association ;

Provides for the payment of 10 per cent upon the amount subscribed ;

If offering Debentures or Debenture Stock states fully the terms of redemption ;

If offering Debentures states whether they are to Bearer or Registered ;

In cases where a company has sold an issue of Capital or Debentures, or Debenture Stock which is subsequently offered for public subscription by either the company or any subsequent purchaser, states the authority for the issue and all material conditions of sale.

(2) That two-thirds of the amount proposed to be issued of any class of shares or securities, whether such issue be the whole or a part of the authorized amount, shall have been applied for by and unconditionally allotted to the public, shares or securities granted in lieu of money payments not being considered to form a part of such public allotment.

(3) That the Articles of Association, and the Trust Deed where such is required, contain the provisions specified hereafter.

(4) That the Certificate or Bond is in the form approved.

(b) ARTICLES OF ASSOCIATION

Articles of Association should contain the following provisions—

(1) That none of the funds of the company shall be employed in the purchase of, or in loans upon the security of its own shares ;

(2) That directors must hold a share qualification ;

(3) That the borrowing powers of the Board are limited ;

(4) That the non-forfeiture of dividends is secured ;

(5) That the common form of transfer shall be used ;

(6) That all Share and Stock Certificates shall be issued under the Common Seal of the company, and shall bear the signatures of one or more directors and the secretary ;

(7) That fully-paid shares shall be free from all lien ;

(8) That the interest of a director in any contract shall be disclosed before execution, and that such director shall not vote in respect thereof ;

(9) That the directors shall have power at any time and from time to time to appoint any other qualified person as a director either to fill a casual vacancy or as an addition to the Board, but so that the total number of directors shall not at any time exceed the maximum number fixed ; but that any director so appointed shall hold office only until the next following Ordinary General Meeting of the company, and shall then be eligible for re-election ;

(10) That a printed copy of the Report, accompanied by the Balance Sheet and Statement of Accounts, shall, at least seven days previous to the General Meeting, be delivered or sent by post to the registered address of every member, and that two copies of each of these documents shall at the same time be forwarded to the secretary of the Share and Loan Department, the Stock Exchange, London ;

(11) That the charge for a new Share Certificate issued to replace one that has been worn out, lost, or destroyed shall not exceed one shilling.

## (c) TRUST DEEDS

Trust Deeds should contain the following provisions—

(1) Where provision is made that the security shall be repayable at a premium, either at a fixed date or at any time upon notice having been given, the Trust Deed must further provide that should the company go into voluntary liquidation for the purpose of amalgamation or reconstruction the security shall not be repayable at a lower price.

(2) The following clause should be inserted in all Deeds—

“The statutory power of appointing new Trustees hereof shall be vested in the company, but a Trustee so appointed must in the first place be approved of by a Resolution of the Debenture (or Debenture Stock) holders passed in the manner specified in the Schedule hereto. A Corporation or Company may be appointed a Trustee of these presents.”

(3) In the clause regulating the convening of meetings of the Debenture (or Debenture Stock) holders, the following words should be inserted, “and the Trustee or Trustees shall do so upon a requisition in writing signed by holders of at least one-tenth of the nominal amount of Debentures (or Debenture Stock) for the time being outstanding.”

(4) The clause defining an “Extraordinary Resolution” must provide that “the expression ‘Extraordinary Resolution’ means a resolution passed at a meeting of the Debenture (or Debenture Stock) holders duly convened and held at which a clear majority in value of the whole of the Debenture (or Debenture Stock) holders is present in person or by proxy and carried by a majority consisting of not less than three-fourths of the persons voting thereat upon a show of hands, and if a poll is demanded then by a majority consisting of not less than three-fourths in value of the votes given on such poll.”

(5) Should Debentures or Debenture Stock be entitled “First Mortgage,” provision must be made for the creation of a specific first mortgage in favour of the Debenture or Debenture Stock holders.

## (d) SHARE AND STOCK CERTIFICATES

All Certificates should state on their face the authority under which the company is constituted and the amount of the authorized capital of the company.

The method of signature must be in accordance with the Articles of Association.

All Certificates should bear a footnote to the effect that no Transfer of any portion of the holding can be registered without the production of the Certificate.

Where the capital of a company consists of more than one class of Shares of the same denomination, the distinctive numbers of the Shares of each class must be printed on the face of the Share Certificates.

All Preference Share Certificates should bear on their face a statement of the company's capital and the conditions, both as to capital and dividends, under which the Shares are issued.

Debentures and Debenture Stock Certificates should, in addition to legal requirements, state on their face the authority under which the company is constituted, the nominal capital of the company, the dates when the interest on the Debentures or Debenture Stock is payable, and the authority under which the issue is made (i.e. Articles of Association and resolutions); and on their back the conditions of issue, redemption, and transfer.

(e)

## BONDS

Bonds must specify the amount and conditions of the loan and the powers under which it has been contracted.

Bonds and Debentures of English companies must be under the Common Seal of the company and must bear the requisite autographic signatures.

When an issue of Colonial or Foreign Bonds or Debentures is made wholly or partly in London, those issued in London must bear the autographic counter signature of the London agents<sup>2</sup> or contractors.

(f)

## NEW COMPANIES

Before the application form can be issued for signature there must be supplied—

A copy of the Prospectus.

Two copies of the Articles of Association.

In the case of Debentures or Debenture Stock the Trust Deed [where possible before execution].

(g) After the application form has been signed there must also be supplied in the case of—

## SHARES

The Certificate of Incorporation, and the Certificate that the company is entitled to commence business.

Two certified copies of the Prospectus, endorsed with the date when first advertised.

Two certified copies of the Memorandum and Articles of Association.

The original Letters of Application.

The Allotment Book containing a List of Applicants, the number applied for by each and the result of each application, with a Summary signed by the Chairman and Secretary.

Should the allotment have taken place at an interval of six months or more before the date of the application, a certified list of present shareholders will also be required.

A copy of the Letter of Allotment and the date when posted.

A Specimen of the Share Certificates.

Authenticated copies of all Concessions and similar documents, with notarially certified printed translations, and certified printed copies of all Contracts and Agreements.

An undertaking—

(1) to change Registered to Bearer Shares in one week, and vice versa ;

- (2) to certify transfers within two days ;
- (3) to certify transfers on Saturdays between the hours of 10.30 and 12.

A Statutory Declaration by the Chairman and Secretary, stating the following particulars—

(1) That the Prospectus complies with the provisions of the Companies (Consolidation) Act, 1908.

(2) That all documents required by the Companies (Consolidation) Act, 1908, have been duly filed with the Registrar of Joint Stock Companies, and the dates of filing.

(3) The number of Shares applied for by the public.

(4) The number of Shares allotted unconditionally to the public (Nos. to ), and the amount per share paid thereon in cash.

(5) The total number of Allottees and the largest number of shares (a) applied for by and (b) allotted to any one applicant.

(6) The number of Shares allotted for a consideration other than cash (being Nos. to ).

(7) That the Share Certificates have been or are ready to be issued.

(8) That the purchase of the property has been completed and the purchase money paid.

(h) After the application form has been signed there must be supplied in the case of—

#### DEBENTURE AND DEBENTURE STOCK

The Certificate of Incorporation, or Act of Parliament, and the Certificate that the company is entitled to commence business.

A Certified printed copy of the Mortgage Deed or other similar document, and the Official Certificate of the Registration of the Mortgage or Charge.

Certified copies of the Articles of Association, Resolutions, or other authority for the present issue.

Two Certified copies of the Prospectus.

The original Letters of Application.

The Allotment Book containing a list of applicants, the amount applied for by each, and the result of each application, with a summary of the whole, signed by the Chairman and Secretary.

Should the allotment have taken place at an interval of six months or more before the date of the application, a Certified List of present Stockholders will also be required.

A copy of the Allotment Letter, and the date when posted.

A specimen of the Debentures or Debenture Stock Certificate, and of the Scrip where Scrip is issued ; Certificates of Debenture Stock allotted to vendors in lieu of money payments being enfaced " Issued to Vendors."

A copy of the last published Report and Accounts.

A Statutory Declaration by the Chairman and Secretary stating—

(1) That the Prospectus complies with the provisions of the Companies (Consolidation) Act, 1908, and that all documents required by that Act have been duly filed with the Registrar of Joint Stock Companies and the dates of filing.

(2) In the case of an English company charging property abroad, that the necessary mortgage has been properly legalized in the country where the property is situated.

(3) The amount of stock applied for by the public.

(4) The amount unconditionally allotted to the public (Nos. to ).

(5) The amount, viz.: £        %, paid thereon in cash.

(6) The amount allotted for a consideration other than cash (Nos. to ).

(7) The total number of allottees.

(8) The largest amount of Debentures or Debenture Stock (a) applied for by, and (b) allotted to any one applicant.

(9) That the Debentures or Debenture Stock Certificates have been or are ready to be issued.

(10) That a Trust Deed has been executed and completed, if such be the case.

(11) The effect of such Trust Deed, and the nature of the charge created thereby in favour of the Debenture holders.

A Statutory Declaration by the Chairman and Secretary stating—

(1) The total amount of the Authorized Capital of the company, and how constituted.

(2) The number of Shares allotted unconditionally to the public (Nos. to ), and the amount paid on each share in cash.

(3) The number of shares taken by Concessionnaires, Owners of Property, Contractors or other parties not included in the public allotment (being Nos. to ).

(4) That the Share Certificates have been or are ready to be issued.

(5) That the purchase of the property has been completed and the purchase money paid.

## (i) SCRIP

In addition to the requirements made in the case of definitive Stock or Bonds, a Specimen of the Scrip Certificate must be supplied.

In cases where a Government, Municipality, Corporation or Company has sold an issue of stock, shares or securities which is subsequently offered for public subscription by the purchaser, evidence must be produced that the purchasing house has received due authority to issue the scrip on account of the Government, Municipality, Corporation or Company, or in the alternative such scrip must be enfaced "Contractors' Scrip."

(k) After the application form has been signed there must be supplied in the case of—

## FURTHER ISSUES

A King's Printers' copy of the Act of Parliament authorizing, the Resolutions, etc., creating, and the Circular or Prospectus offering the new issue.

If Shares have been issued credited as fully or partly paid, certified printed copies of the Contracts relating thereto.

A copy of the Allotment Letter.

A copy of the last Report and Accounts.

A specimen of the Share Certificate.

The Allotment Book unless the allotment is *pro rata*.

An undertaking

(1) To change Registered to Bearer shares in one week, and vice versa ;

(2) To certify transfers within two days ;

(3) To certify transfers on Saturdays between the hours of 10.30 and 12.

A Statutory Declaration by the Secretary stating—

(1) That the Prospectus or Circular complies with the provisions of the Companies (Consolidation) Act, 1908 ;

(2) That all documents required by the Companies (Consolidation) Act, 1908, have been duly filed with the Registrar of Joint Stock Companies, and the dates of filing ;

(3) That the shares (Nos.        to        ) have been applied for by and unconditionally allotted to the shareholders or the public or sold upon the market, as the case may be ;

(4) The amount per share paid in cash ;

(5) The total number of Allottees, and the largest number of Shares applied for by and allotted to any one applicant ;

(6) That the Certificates have been or are ready to be issued ;

(7) That no impediment exists to the settlement of the Account ;

(8) It must also be stated whether or not the Shares are in all respects identical with those already quoted in the Official List.

The statement that Shares are in all respects identical means that—

They are of the same nominal value, and that the same amount per Share has been called up.

They carry the same rights as to unrestricted transfer, attendance, and voting at meetings, and in all other respects.

They are entitled to dividend at the same rate and for the same period, so that at the next ensuing distribution the dividend payable on each Share will amount to exactly the same sum.

The statement that Stock is in all respects identical means that—

All the Stock is entitled to the same rights as to unrestricted transfer, and in all other respects.

All the Stock is entitled to dividend at the same rate and for the same period, so that at the next ensuing distribution the dividend payable on each £100 of the Stock will amount to exactly the same sum.



(l) After the application form has been signed there must be supplied in the case of—

#### VENDORS' SHARES

A Certified List of the present holders of the Vendors' Shares.

A Certified Copy of the last published Report and Accounts of the company.

A specimen of the Share Certificate.

A Statutory Declaration by the Secretary stating—

(1) That the Vendors' Shares (Nos.            to            ) have all been issued and Certificates delivered ;

(2) That the shares are in all respects identical with those already quoted in the Official List.

(m) After the application form has been signed there must be supplied in the case of—

#### OLD COMPANIES

The Certificate of Incorporation, or Act of Parliament, and the Certificate that the company is entitled to commence business.

Authenticated copies of all Concessions and similar documents, with notarially certified printed translations.

Certified copies of all Prospectuses, original or otherwise, endorsed with the date when first advertised.

Two Certified copies of the Memorandum and Articles of Association.

A Specimen of the Share Certificate and of the Allotment Letter.

A Certified copy of present Register of Shareholders.

Certified printed copies of Contracts, Agreements, etc., together with copies of all Contracts relating to the issue of Shares credited as fully or partly paid.

A Certified copy of the company's last published Report and Accounts.

A short history of the company, setting forth its origin, progress, dividends, etc., the number of transfers registered during the last twelve months, and the number of Shares represented by such transfers.

An undertaking

(1) To change Registered to Bearer Shares in one week, and vice versa ;

(2) To certify transfers within two days ;

(3) To certify transfers on Saturdays between the hours of 10.30 and 12.

Statutory Declaration by the Chairman and Secretary stating the following particulars—

(1) That the Prospectus complied with the provisions of the Companies (Consolidation) Act, 1908.

(2) That all documents required by the Companies (Consolidation) Act, 1908, have been duly filed with the Registrar of Joint Stock Companies, and the dates of filing.

(3) The number of Shares applied for by the public.

(4) The number of Shares allotted unconditionally to the public

(Nos.            to            ), and the amount per share paid thereon in cash (being Nos.            to            ).

(6) That the Share Certificates have been or are ready to be issued.

(7) That the purchase of the properties has been completed and the purchase money paid.

(n) After the application form has been signed, there must be supplied in the case of—

#### COLONIAL AND FOREIGN COMPANIES

The Certificate of Incorporation or Act of Parliament, or other similar document.

Two copies of the Statutes or Articles of Association or notarial translations of the same.

A Certified List of present Shareholders.

A Specimen of the Share Certificate.

Copies of all Agreements, Concessions, Deeds, etc., or notarially certified printed translations of the same.

A Certified copy of last published Report and Accounts, or translation of the same.

Official evidence of quotation in the country to which they belong, or where the issue has been made.

A short history of the establishment and progress of the company from its incorporation to the present time, including particulars as to the issue of the Capital.

A Declaration stating—

(1) The number of Shares allotted ;

(2) The amount per Share paid in cash ;

(3) That the Share Certificates have been or are ready to be issued ;

(4) That no impediment exists to the settlement of the Account.

(o) After the application form has been signed, there must be supplied in the case of—

#### RECONSTRUCTED COMPANIES

The Certificate of Incorporation, and the Certificate that the company is entitled to commence business.

A statement of the plan of reconstruction, together with certified copies of all resolutions passed and circulars issued in connection with the reconstruction.

The Allotment Book, with a Summary signed by the Chairman and Secretary.

The Allotment Letter, and the date when posted.

A Specimen of the Share Certificate.

Two Certified copies of the Memorandum and Articles of Association.

Certified printed copies of all Contracts, Agreements, etc.

Copies of all Contracts relating to the issue of fully or partly paid Shares.

An undertaking

(1) To change Registered to Bearer Shares in one week, and vice versa ;

(2) To certify transfers within two days ;

(3) To certify transfers on Saturdays between 10.30 and 12.

A Statutory Declaration by the Chairman and Secretary stating—

(1) That all Documents required by the Companies (Consolidation) Act, 1908, have been duly filed with the Registrar of Joint Stock Companies and dates of filing.

(2) The Authorized Capital of the company.

(3) The number of Shares to which shareholders in the old company were entitled; the number and distinctive numbers of Shares unconditionally allotted to such Shareholders; and the amount per Share (a) paid thereon in cash, and (b) credited as paid up.

(4) The number and distinctive numbers of Shares applied for by and allotted unconditionally to the public, and the amount per share (a) credited as paid up, and (b) paid thereon in cash.

(5) That the Share Certificates have been or are ready to be issued.

(6) That no impediment exists to the settlement of the Account.

(p) After the application form has been signed the following documents must be supplied in the case of—

#### LOANS

Details of the creation of the Loan, and the authority under which it is issued, including authenticated copies of concessions, etc., with notarially certified translations.

The Authority to the Agents or Contractors to receive subscriptions.

A Certified Copy of the Prospectus.

Evidence that all Bonds issued and payable abroad bear the signature of some properly authorized person.

A specimen Bond, together with a Bond duly executed, or Scrip Certificate if issued.

Statutory Declaration by the Agents, stating—

(1) The amount allotted unconditionally to the public.

(2) The numbers and denominations of those Bonds which bear the autographic signature of the London Agents or Contractors.

(3) That the required amount, viz., £        per cent, has been paid thereon in cash.

(4) That the Scrip or Bonds have been or are ready to be issued.

(5) That no impediment exists to the settlement of the Account.

(q) After the application form has been signed the following documents must be supplied in the case of—

#### BONDS QUOTED ABROAD

Official evidence of quotation in the country to which they belong or where the issue has been made.

Notarially certified printed translations of all Prospectuses, and of the Laws creating and authorizing the Loan.

A Specimen Bond, together with a Bond duly executed.

An Official Certificate setting forth—

(1) The authorized and issued amounts of the Loan, and the terms of issue.

(2) The distinctive numbers and denominations of the Bonds.

(3) Evidence that all Bonds bear the autographic signature of some properly authorized person.

# APPENDIX A

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## REGULATIONS FOR MANAGEMENT OF A COMPANY LIMITED BY SHARES

BEING

### TABLE A

OF THE FIRST SCHEDULE OF THE COMPANIES (CONSOLIDATION)  
ACT, 1908

#### PRELIMINARY

(1) In these regulations, unless the context otherwise requires, expressions defined in the Companies (Consolidation) Act, 1908, or any statutory modification thereof in force at the date at which these regulations become binding on the company, shall have the meanings so defined ; and words importing the singular shall include the plural, and vice versa, and words importing the masculine gender shall include females, and words importing persons shall include bodies corporate.

#### BUSINESS

(2) The directors shall have regard to the restrictions on the commencement of business imposed by section eighty-seven of the Companies (Consolidation) Act, 1908, if, and so far as, those restrictions are binding upon the company.

#### SHARES

(3) Subject to the provisions, if any, in that behalf of the memorandum of association of the company, and without prejudice to any special rights previously conferred on the holders of existing shares in the company, any share in the company may be issued with such preferred, deferred, or other special rights, or such restrictions, whether in regard to dividend, voting, return of share capital or otherwise, as the company may from time to time by special resolution determine.

(4) If at any time the share capital is divided into different classes of shares, the rights attached to any class (unless otherwise provided by the terms of issue of the shares of that class) may be varied with the consent in writing of the holders of three-fourths of the issued shares of that class, or with the sanction of an extraordinary resolution passed at a separate general meeting of the holders of the shares of the class. To every such separate general meeting the provisions of these regulations relating to general meetings shall *mutatis mutandis* apply, but so that the necessary quorum shall be two persons at least holding or representing by proxy one-third of the issued shares of the class.

(5) No share shall be offered to the public for subscription except upon the terms that the amount payable on application shall be at

least five per cent of the nominal amount of the share; and the directors shall, as regards any allotment of shares, duly comply with such of the provisions of sections eighty-five and eighty-eight of the Companies (Consolidation) Act, 1908, as may be applicable thereto.

(6) Every person whose name is entered as a member in the register of members shall, without payment, be entitled to a certificate under the common seal of the company specifying the share or shares held by him and the amount paid up thereon, provided that in respect of a share or shares held jointly by several persons the company shall not be bound to issue more than one certificate, and delivery of a certificate for a share to one of several joint holders shall be sufficient delivery to all.

(7) If a share certificate is defaced, lost, or destroyed, it may be renewed on payment of such fee, if any, not exceeding one shilling, and on such terms, if any, as to evidence and indemnity as the directors think fit.

(8) No part of the funds of the company shall be employed in the purchase of or in loans upon the security of the company's shares.

#### LIEN

(9) The company shall have a lien on every share (not being a fully-paid share) for all moneys (whether presently payable or not) called or payable at a fixed time in respect of that share, and the company shall also have a lien on all shares (other than fully-paid shares) standing registered in the name of a single person, for all moneys presently payable by him or his estate to the company; but the directors may at any time declare any share to be wholly or in part exempt from the provisions of this clause. The company's lien, if any, on a share shall extend to all dividends payable thereon.

(10) The company may sell, in such manner as the directors think fit, any shares on which the company has a lien, but no sale shall be made unless some sum in respect of which the lien exists is presently payable, nor until the expiration of fourteen days after a notice in writing, stating and demanding payment of such part of the amount in respect of which the lien exists as is presently payable, has been given to the registered holder for the time being of the share, or the person entitled by reason of his death or bankruptcy to the share.

(11) The proceeds of the sale shall be applied in payment of such part of the amount in respect of which the lien exists as is presently payable, and the residue shall (subject to a like lien for sums not presently payable as existed upon the shares prior to the sale) be paid to the person entitled to the shares at the date of the sale. The purchaser shall be registered as the holder of the shares, and he shall not be bound to see to the application of the purchase money, nor shall his title to the shares be affected by any irregularity or invalidity in the proceedings in reference to the sale.

#### CALLS ON SHARES

(12) The directors may from time to time make calls upon the members in respect of any moneys unpaid on their shares, provided that no call shall exceed one-fourth of the nominal amount of the share, or be payable at less than one month from the last call; and each member shall (subject to receiving at least fourteen days'

notice specifying the time or times of payment) pay to the company at the time or times so specified the amount called on his shares.

(13) The joint holders of a share shall be jointly and severally liable to pay all calls in respect thereof.

(14) If a sum called in respect of a share is not paid before or on the day appointed for payment thereof, the person from whom the sum is due shall pay interest upon the sum at the rate of  $\frac{1}{2}$  per cent per annum from the day appointed for the payment thereof to the time of the actual payment, but the directors shall be at liberty to waive payment of that interest wholly or in part.

(15) The provisions of these regulations as to payment of interest shall apply, in the case of non-payment of any sum which, by the terms of issue of a share, becomes payable at a fixed time, whether on account of the amount of the share, or by way of premium, as if the same had become payable by virtue of a call duly made and notified.

(16) The directors may make arrangements on the issue of shares for a difference between the holders in the amount of calls to be paid and in the times of payment.

(17) The directors may, if they think fit, receive from any member willing to advance the same all or any part of the moneys uncalled and unpaid upon any shares held by him; and upon all or any of the moneys so advanced may (until the same would, but for such advance, become presently payable) pay interest at such rate (not exceeding without the sanction of the company in general meeting six per cent) as may be agreed upon between the member paying the sum in advance and the directors.

#### TRANSFER AND TRANSMISSION OF SHARES

(18) The instrument of transfer of any share in the company shall be executed both by the transferor and transferee, and the transferor shall be deemed to remain a holder of the share until the name of the transferee is entered in the register of members in respect thereof.

(19) Shares in the company shall be transferred in the following form, or in any usual or common form which the directors shall approve—

I, A.B. of \_\_\_\_\_ in consideration of the sum of  
 £ \_\_\_\_\_ paid to me by C.D. of \_\_\_\_\_  
 (hereinafter called "the said transferee") do hereby transfer to  
 the said transferee the share [or shares] numbered \_\_\_\_\_  
 in the undertaking called the \_\_\_\_\_ Company  
 Limited, to hold unto the said transferee, his executors, admin-  
 istrators and assigns, subject to the several conditions on which  
 I held the same at the time of the execution thereof: and I, the  
 said transferee, do hereby agree to take the said share [or shares]  
 subject to the conditions aforesaid. As witness our hands, the  
 day of \_\_\_\_\_

Witness to the signature of, etc.

(20) The directors may decline to register any transfer of shares, not being fully-paid shares, to a person of whom they do not approve, and may also decline to register any transfer of shares on which the company has a lien. The directors may also suspend the

registration of transfers during the fourteen days immediately preceding the ordinary general meeting in each year. The directors may decline to recognize any instrument of transfer unless (a) a fee not exceeding two shillings and sixpence is paid to the company in respect thereof, and (b) the instrument of transfer is accompanied by the certificates of the shares to which it relates, and such other evidence as the directors may reasonably require to show the right of the transferor to make the transfer.

(21) The executors or administrators of a deceased sole holder of a share shall be the only persons recognized by the company as having any title to the share. In the case of a share registered by the names of two or more holders, the survivors or survivor, or the executors or administrators of the deceased survivor, shall be the only persons recognized by the company as having any title to the share.

(22) Any person becoming entitled to a share in consequence of the death or bankruptcy of a member shall, upon such evidence being produced as may from time to time be required by the directors, have the right, either to be registered as a member in respect of the share, or, instead of being registered himself, to make such transfer of the share as the deceased or bankrupt person could have made; but the directors shall, in either case, have the same right to decline or suspend registration as they would have had in the case of a transfer of the share by the deceased or bankrupt person before the death or bankruptcy.

(23) A person becoming entitled to a share by reason of the death or bankruptcy of the holder shall be entitled to the same dividends and other advantages to which he would be entitled if he were the registered holder of the share, except that he shall not, before being registered as a member in respect of the share, be entitled in respect of it to exercise any right conferred by membership in relation to meetings of the company.

#### FORFEITURE OF SHARES

(24) If a member fails to pay any call or instalment of a call on the day appointed for payment thereof, the directors may, at any time thereafter during such time as any part of such call or instalment remains unpaid, serve a notice on him requiring payment of so much of the call or instalment as is unpaid, together with any interest which may have accrued.

(25) The notice shall name a further day (not earlier than the expiration of fourteen days from the date of the notice) on or before which the payment required by the notice is to be made, and shall state that in the event of non-payment at or before the time appointed the shares in respect of which the call was made will be liable to be forfeited.

(26) If the requirements of any such notice as aforesaid are not complied with, any share in respect of which the notice has been given may at any time thereafter, before the payment required by the notice has been made, be forfeited by a resolution of the directors to that effect.

(27) A forfeited share may be sold or otherwise disposed of on such terms and in such manner as the directors think fit, and at any time before a sale or disposition the forfeiture may be cancelled on such terms as the directors think fit.

(28) A person whose shares have been forfeited shall cease to be a member in respect of the forfeited shares, but shall, notwithstanding, remain liable to pay to the company all moneys which, at the date of forfeiture, were presently payable by him to the company in respect of the shares, but his liability shall cease if and when the company receive payment in full of the nominal amount of the shares.

(29) A statutory declaration in writing that the declarant is a director of the company, and that a share in the company has been duly forfeited on a date stated in the declaration, shall be conclusive evidence of the facts therein stated as against all persons claiming to be entitled to the share, and that declaration, and the receipt of the company for the consideration, if any, given for the share on the sale or disposition thereof shall constitute a good title to the share, and the person to whom the share is sold or disposed of shall be registered as the holder of the share and shall not be bound to see to the application of the purchase money, if any, nor shall his title to the share be affected by any irregularity or invalidity in the proceedings in reference to the forfeiture, sale, or disposal of the share.

(30) The provisions of these regulations as to forfeiture shall apply in the case of non-payment of any sum which, by the terms of issue of a share, becomes payable at a fixed time, whether on account of the amount of the share, or by way of premium, as if the same had been payable by virtue of a call duly made and notified.

#### CONVERSION OF SHARES INTO STOCK

(31) The directors may, with the sanction of the company previously given in general meeting, convert any paid-up shares into stock, and may with the like sanction reconvert any stock into paid-up shares of any denomination.

(32) The holders of stock may transfer the same, or any part thereof, in the same manner, and subject to the same regulations as, and subject to which the shares from which the stock arose might previously to conversion have been transferred, or as near thereto as circumstances admit; but the directors may from time to time fix the minimum amount of stock transferable, and restrict or forbid the transfer of fractions of that minimum, but the minimum shall not exceed the nominal amount of the shares from which the stock arose.

(33) The holders of stock shall, according to the amount of the stock held by them, have the same rights, privileges, and advantages, as regards dividends, voting at meetings of the company, and other matters as if they held the shares from which the stock arose, but no such privilege or advantage (except participation in the dividends and profits of the company) shall be conferred by any such aliquot part of stock as would not, if existing in shares, have conferred that privilege or advantage.

(34) Such of the regulations of the company (other than those relating to share warrants) as are applicable to paid-up shares shall apply to stock, and the words "share" and "shareholder" therein shall include "stock" and "stock-holder."



## SHARE WARRANTS

(35) The company may issue share warrants, and accordingly the directors may in their discretion, with respect to any share which is fully paid up, on application in writing signed by the person registered as holder of the share, and authenticated by such evidence, if any, as the directors may from time to time require as to the identity of the person signing the request, and on receiving the certificate, if any, of the share, and the amount of the stamp duty on the warrant and such fee as the directors may from time to time require, issue under the company's seal a warrant, duly stamped, stating that the bearer of the warrant is entitled to the shares therein specified, and may provide by coupons, or otherwise, for the payment of dividends, or other moneys, on the shares included in the warrant.

(36) A share warrant shall entitle the bearer to the shares included in it, and the shares shall be transferred by the delivery of the share warrant, and the provisions of the regulations of the company with respect to transfer and transmission of shares shall not apply thereto.

(37) The bearer of a share warrant shall, on surrender of the warrant to the company for cancellation, and on payment of such sum as the directors may from time to time prescribe, be entitled to have his name entered as a member in the register of members in respect of the shares included in the warrant.

(38) The bearer of a share warrant may at any time deposit the warrant at the office of the company, and so long as the warrant remains so deposited the depositor shall have the same right of signing a requisition for calling a meeting of the company, and of attending and voting and exercising the other privileges of a member at any meeting held after the expiration of two clear days from the time of deposit, as if his name were inserted in the register of members as the holder of the shares included in the deposited warrant. Not more than one person shall be recognized as depositor of the share warrant. The company shall on two days' written notice return the deposited share warrant to the depositor.

(39) Subject as herein otherwise expressly provided no person shall, as bearer of a share warrant, sign a requisition for calling a meeting of the company, or attend, or vote, or exercise any other privilege of a member at a meeting of the company, or be entitled to receive any notices from the company; but the bearer of a share warrant shall be entitled in all other respects to the same privileges and advantages as if he were named in the register of members as the holder of the shares included in the warrant, and he shall be a member of the company.

(40) The directors may from time to time make rules as to the terms on which (if they shall think fit) a new share warrant or coupon may be issued by way of renewal in case of defacement, loss, or destruction.

## ALTERATION OF CAPITAL

(41) The directors may, with the sanction of an extraordinary resolution of the company, increase the share capital by such sum, to be divided into shares of such amount, as the resolution shall prescribe.

(42) Subject to any direction to the contrary that may be given by the resolution sanctioning the increase of share capital, all new shares shall, before issue, be offered to such persons as at the date of the offer are entitled to receive notices from the company of general meetings in proportion, as nearly as the circumstances admit, to the amount of the existing shares to which they are entitled. The offer shall be made by notice specifying the number of shares offered, and limiting a time within which the offer, if not accepted, will be deemed to be declined, and after the expiration of that time, or on the receipt of an intimation from the person to whom the offer is made that he declines to accept the shares offered, the directors may dispose of the same in such manner as they think most beneficial to the company. The directors may likewise so dispose of any new shares which (by reason of the ratio which the new shares bear to shares held by persons entitled to an offer of new shares) cannot, in the opinion of the directors, be conveniently offered under this article.

(43) The new shares shall be subject to the same provisions with reference to the payment of calls, lien, transfer, transmission, forfeiture and otherwise as the shares in the original share capital.

(44) The company may, by special resolution—

(a) Consolidate and divide its share capital into shares of larger amount than its existing shares.

(b) By sub-division of its existing shares, or any of them, divide the whole, or any part, of its share capital into shares of smaller amount than is fixed by the Memorandum of Association, subject, nevertheless, to the provisions of paragraph (d) of subsection (1) of section forty-one of the Companies (Consolidation) Act, 1908.

(c) Cancel any shares which, at the date of the passing of the resolution, have not been taken or agreed to be taken by any person.

(d) Reduce its share capital in any manner and with, and subject to, any incident authorized, and consent required, by law.

#### GENERAL MEETINGS

(45) The statutory general meeting of the company shall be held within the period required by section sixty-five of the Companies (Consolidation) Act, 1908.

(46) A general meeting shall be held once in every year at such time (not being more than fifteen months after the holding of the last preceding general meeting) and place as may be prescribed by the company in general meeting, or, in default, at such time in the month following that in which the anniversary of the company's incorporation occurs, and at such place, as the directors shall appoint. In default of a general meeting being so held, a general meeting shall be held in the month next following, and may be convened by any two members in the same manner as nearly as possible as that in which meetings are to be convened by the directors.

(47) The above-mentioned general meetings shall be called ordinary meetings; all other general meetings shall be called extraordinary.

(48) The directors may, whenever they think fit, convene an

extraordinary general meeting, and extraordinary general meetings shall also be convened on such requisition, or, in default, may be convened by such requisitionists as provided by section sixty-six of the Companies (Consolidation) Act, 1908. If at any time there are not within the United Kingdom sufficient directors capable of acting to form a quorum, any director or any two members of the company may convene an extraordinary general meeting in the same manner as nearly as possible as that in which meetings may be convened by the directors.

#### PROCEEDINGS AT GENERAL MEETING

(49) Seven days' notice at the least (exclusive of the day on which the notice is served or deemed to be served, but inclusive of the day for which notice is given) specifying the place, the day, and the hour of meeting and, in case of special business, the general nature of that business, shall be given in manner hereinafter mentioned, or in such other manner, if any, as may be prescribed by the company in general meeting, to such persons as are, under the regulations of the company, entitled to receive such notices from the company; but the non-receipt of the notice by any member shall not invalidate the proceedings at any general meeting.

(50) All business shall be deemed special that is transacted at an extraordinary meeting, and all that is transacted at an ordinary meeting, with the exception of sanctioning a dividend, the consideration of the accounts, balance sheets, and the ordinary report of the directors and auditors, the election of directors and other officers in the place of those retiring by rotation, and the fixing of the remuneration of the auditors.

(51) No business shall be transacted at any general meeting unless a quorum of members is present at the time when the meeting proceeds to business; save as herein otherwise provided, three members personally present shall be a quorum.

(52) If within half an hour from the time appointed for the meeting a quorum is not present, the meeting, if convened upon the requisition of members, shall be dissolved; in any other case it shall stand adjourned to the same day in the next week, at the same time and place, and, if at the adjourned meeting a quorum is not present within half an hour from the time appointed for the meeting, the members present shall be a quorum.

(53) The chairman, if any, of the board of directors shall preside as chairman at every general meeting of the company.

(54) If there is no such chairman, or if at any meeting he is not present within fifteen minutes after the time appointed for holding the meeting, or is unwilling to act as chairman, the members present shall choose some one of their number to be chairman.

(55) The chairman may, with the consent of any meeting at which a quorum is present (and shall if so directed by the meeting), adjourn the meeting from time to time and from place to place, but no business shall be transacted at any adjourned meeting other than the business left unfinished at the meeting from which the adjournment took place. When a meeting is adjourned for ten days or more, notice of the adjourned meeting shall be given as in the case of an original meeting. Save as aforesaid it shall not be necessary

to give any notice of an adjournment or of the business to be transacted at an adjourned meeting.

(56) At any general meeting a resolution put to the vote of the meeting shall be decided on a show of hands, unless a poll is (before or on the declaration of the result of the show of hands) demanded by at least three members, and, unless a poll is so demanded, a declaration by the chairman that a resolution has, on a show of hands, been carried, or carried unanimously, or by a particular majority, or lost, and an entry to that effect in the book of the proceedings of the company, shall be conclusive evidence of the fact, without proof of the number or proportion of the votes recorded in favour of, or against, that resolution.

(57) If a poll is duly demanded it shall be taken in such manner as the chairman directs, and the result of the poll shall be deemed to be the resolution of the meeting at which the poll was demanded.

(58) In the case of an equality of votes, whether on a show of hands or on a poll, the chairman of the meeting at which the show of hands takes place or at which the poll is demanded, shall be entitled to a second or casting vote.

(59) A poll demanded on the election of a chairman, or on a question of adjournment, shall be taken forthwith. A poll demanded on any other question shall be taken at such time as the chairman of the meeting directs.

#### VOTES OF MEMBERS

(60) On a show of hands every member present in person shall have one vote. On a poll every member shall have one vote for each share of which he is the holder.

(61) In the case of joint holders the vote of the senior who tenders a vote, whether in person or by proxy, shall be accepted to the exclusion of the votes of the other joint holders; and for the purpose seniority shall be determined by the order in which the names stand in the register of members.

(62) A member of unsound mind, or in respect of whom an order has been made by any court having jurisdiction in lunacy, may vote, whether on a show of hands or on a poll, by his committee, curator bonis, or other person in the nature of a committee or curator bonis appointed by that court, and any such committee, curator bonis, or other person may, on a poll, vote by proxy.

(63) No member shall be entitled to vote at any general meeting unless all calls or other sums presently payable by him in respect of shares in the company have been paid.

(64) On a poll votes may be given either personally or by proxy.

(65) The instrument appointing a proxy shall be in writing under the hand of the appointor or of his attorney duly authorized in writing, or, if the appointor is a corporation, either under the common seal, or under the hand of an officer or attorney so authorized. No person shall act as a proxy unless either he is entitled on his own behalf to be present and vote at the meeting at which he acts as proxy, or he has been appointed to act at that meeting as proxy for a corporation.

(66) The instrument appointing a proxy and the power of attorney or other authority, if any, under which it is signed or a notarially certified copy of that power or authority shall be deposited at the

registered office of the company not less than forty-eight hours before the time for holding the meeting at which the person named in the instrument proposes to vote, and in default the instrument of proxy shall not be treated as valid.

(67) An instrument appointing a proxy may be in the following form, or in any other form which the directors shall approve—

I, \_\_\_\_\_, of \_\_\_\_\_, in the County of \_\_\_\_\_,  
being a member of the \_\_\_\_\_  
Company, Limited, hereby appoint \_\_\_\_\_ of \_\_\_\_\_  
as my proxy to vote for me and on my behalf at the [ordinary or  
extraordinary, as the case may be] general meeting of the company  
to be held on the \_\_\_\_\_ day of \_\_\_\_\_ and at any  
adjournment thereof.  
Signed this \_\_\_\_\_ day of \_\_\_\_\_

## DIRECTORS

(68) The number of the directors and the names of the first directors shall be determined in writing by a majority of the subscribers of the memorandum of association.

(69) The remuneration of the directors shall from time to time be determined by the company in general meeting.

(70) The qualification of a director shall be the holding of at least one share in the company, and it shall be his duty to comply with the provisions of section seventy-three of the Companies (Consolidation) Act, 1908.

## POWERS AND DUTIES OF DIRECTORS

(71) The business of the company shall be managed by the directors, who may pay all expenses incurred in getting up and registering the company, and may exercise all such powers of the company as are not, by the Companies (Consolidation) Act, 1908, or any statutory modification thereof for the time being in force, or by these articles, required to be exercised by the company in general meeting, subject nevertheless to any regulation of these articles, to the provisions of the said Act, and to such regulations, being not inconsistent with the aforesaid regulations or provisions, as may be prescribed by the company in general meeting; but no regulations made by the company in general meeting shall invalidate any prior act of the directors which would have been valid if that regulation had not been made.

(72) The directors may from time to time appoint one or more of their body to the office of managing director or manager for such term, and at such remuneration (whether by way of salary, or commission, or participation in profits, or partly in one way and partly in another) as they may think fit, and a director so appointed shall not, while holding that office, be subject to retirement by rotation, or taken into account in determining the rotation of retirement of directors; but his appointment shall be subject to determination *ipso facto* if he ceases from any cause to be a director, or if the company in general meeting resolve that his tenure of the office of managing director or manager be determined.

(73) The amount for the time being remaining undischarged of moneys borrowed or raised by the directors for the purposes of the company (otherwise than by the issue of share capital) shall not at any time exceed the issued share capital of the company without the sanction of the company in general meeting.

(74) The directors shall duly comply with the provisions of the Companies (Consolidation) Act, 1908, or any statutory modification thereof for the time being in force, and in particular with the provisions in regard to the registration of the particulars of mortgages and charges affecting the property of the company, or created by it, and to keeping a register of the directors, and to sending to the Registrar of Companies an annual list of members, and a summary of particulars relating thereto, and notice of any consolidation or increase of share capital, or conversion of shares into stock, and copies of special resolutions, and a copy of the register of directors and notifications of any changes therein.

(75) The directors shall cause minutes to be made in books provided for the purpose—

- (a) Of all appointments of officers made by the directors ;
  - (b) Of the names of the directors present at each meeting of the directors and of any committee of the directors ;
  - (c) Of all resolutions and proceedings at all meetings of the company, and of the directors, and of committees of directors ;
- and every director present at any meeting of directors or committee of directors shall sign his name in a book to be kept for that purpose.

#### THE SEAL

(76) The seal of the company shall not be affixed to any instrument except by the authority of a resolution of the board of directors, and in the presence of at least two directors and of the secretary or such other person as the directors may appoint for the purpose ; and those two directors and secretary or other person as aforesaid shall sign every instrument to which the seal of the company is so affixed in their presence.

#### DISQUALIFICATIONS OF DIRECTORS

(77) The office of director shall be vacated, if the director—

- (a) Ceases to be a director by virtue of section seventy-three of the Companies (Consolidation) Act, 1908 ; or
- (b) Holds any other office of profit under the company except that of managing director or manager ; or
- (c) Becomes bankrupt ; or
- (d) Is found lunatic or becomes of unsound mind ; or
- (e) Is concerned or participates in the profits of any contract with the company :

Provided, however, that no director shall vacate his office by reason of his being a member of any company which has entered into contracts with or done any work for the company of which he is director ; but a director shall not vote in respect of any such contract or work, and if he does so vote his vote shall not be counted.

#### ROTATION OF DIRECTORS

(78) At the first ordinary meeting of the company the whole of the directors shall retire from office, and at the ordinary meeting

in every subsequent year one-third of the directors for the time being, or, if their number is not three or a multiple of three, then the number nearest to one-third, shall retire from office.

(79) The directors to retire in every year shall be those who have been longest in office since their last election, but as between persons who became directors on the same day those to retire shall (unless they otherwise agree among themselves) be determined by lot.

(80) A retiring director shall be eligible for re-election.

(81) The company at the general meeting at which a director retires in manner aforesaid may fill up the vacated office by electing a person thereto.

(82) If at any meeting at which an election of directors ought to take place the places of the vacating directors are not filled up, the meeting shall stand adjourned till the same day in the next week at the same time and place, and, if at the adjourned meeting the places of the vacating directors are not filled up, the vacating directors, or such of them as have not had their places filled up, shall be deemed to have been re-elected at the adjourned meeting.

(83) The company may from time to time in general meeting increase or reduce the number of directors, and may also determine in what rotation the increased or reduced number is to go out of office.

(84) Any casual vacancy occurring in the board of directors may be filled up by the directors, but the person so chosen shall be subject to retirement at the same time as if he had become a director on the day on which the director in whose place he is appointed was last elected a director.

(85) The directors shall have power at any time, and from time to time, to appoint a person as an additional director who shall retire from office at the next following ordinary general meeting, but shall be eligible for election by the company at that meeting as an additional director.

(86) The company may by extraordinary resolution remove any director before the expiration of his period of office, and may by an ordinary resolution appoint another person in his stead; the person so appointed shall be subject to retirement at the same time as if he had become a director on the day on which the director in whose place he is appointed was last elected a director.

#### PROCEEDINGS OF DIRECTORS

(87) The directors may meet together for the despatch of business, adjourn, and otherwise regulate their meetings, as they think fit. Questions arising at any meeting shall be decided by a majority of votes. In case of an equality of votes the chairman shall have a second or casting vote. A director may, and the secretary on the requisition of a director shall, at any time summon a meeting of the directors.

(88) The quorum necessary for the transaction of the business of the directors may be fixed by the directors, and unless so fixed shall (when the number of directors exceeds three) be three.

(89) The continuing directors may act notwithstanding any vacancy in their body, but, if and so long as their number is reduced below the number fixed by or pursuant to the regulations of the company as the necessary quorum of directors, the continuing

directors may act for the purpose of increasing the number of directors to that number, or of summoning a general meeting of the company, but for no other purpose.

(90) The directors may elect a chairman of their meetings and determine the period for which he is to hold office ; but, if no such chairman is elected, or if at any meeting the chairman is not present within five minutes after the time appointed for holding the same the directors present may choose one of their number to be chairman of the meeting.

(91) The directors may delegate any of their powers to committees consisting of such member or members of their body as they think fit ; any committee so formed shall in the exercise of the powers so delegated conform to any regulations that may be imposed on them by the directors.

(92) A committee may elect a chairman of their meetings : if no such chairman is elected, or if at any meeting the chairman is not present within five minutes after the time appointed for holding the same, the members present may choose one of their number to be chairman of the meeting.

(93) A committee may meet and adjourn as they think proper. Questions arising at any meeting shall be determined by a majority of votes of the members present, and in case of an equality of votes the chairman shall have a second or casting vote.

(94) All acts done by any meeting of the directors or of a committee of directors, or by any person acting as a director, shall, notwithstanding that it be afterwards discovered that there was some defect in the appointment of any such directors or persons acting as aforesaid, or that they or any of them were disqualified, be as valid as if every such person had been duly appointed and was qualified to be a director.

#### DIVIDENDS AND RESERVE

(95) The company in general meeting may declare dividends, but no dividend shall exceed the amount recommended by the directors.

(96) The directors may from time to time pay to the members such interim dividends as appear to the directors to be justified by the profits of the company.

(97) No dividend shall be paid otherwise than out of profits.

(98) Subject to the rights of persons, if any, entitled to shares with special rights as to dividends, all dividends shall be declared and paid according to the amounts paid on the shares, but if and so long as nothing is paid up on any of the shares in the company dividends may be declared and paid according to the amounts of the shares. No amount paid on a share in advance of calls shall, while carrying interest, be treated for the purposes of this article as paid on the share.

(99) The directors may, before recommending any dividend, set aside out of the profits of the company such sums as they think proper as a reserve or reserves which shall, at the discretion of the directors, be applicable for meeting contingencies, or for equalizing dividends, or for any other purpose to which the profits of the company may be properly applied, and pending such application may, at the like discretion, either be employed in the business of the company or be invested in such investments (other than shares



of the company) as the directors may from time to time think fit.

(100) If several persons are registered as joint holders of any share any one of them may give effectual receipts for any dividend payable on the share.

(101) Notice of any dividend that may have been declared shall be given in manner hereinafter mentioned to the persons entitled to share therein.

(102) No dividend shall bear interest against the company.

#### ACCOUNTS

(103) The directors shall cause true accounts to be kept—

Of the sums of money received and expended by the company and the matter in respect of which such receipt and expenditure takes place; and

Of the assets and liabilities of the company.

(104) The books of account shall be kept at the registered office of the company, or at such other place or places as the directors think fit, and shall always be open to the inspection of the directors.

(105) The directors shall from time to time determine whether and to what extent and at what times and places and under what conditions or regulations the accounts and books of the company or any of them shall be open to the inspection of members not being directors, and no member (not being a director) shall have any right of inspecting any account or book or document of the company except as conferred by statute or authorized by the directors or by the company in general meeting.

(106) Once at least in every year the directors shall lay before the company in general meeting a profit and loss account for the period since the preceding account or (in the case of the first account) since the incorporation of the company, made up to a date not more than six months before such meeting.

(107) A balance sheet shall be made out in every year and laid before the company in general meeting made up to a date not more than six months before such meeting. The balance sheet shall be accompanied by a report of the directors as to the state of the company's affairs, and the amount which they recommend to be paid by way of dividend, and the amount, if any, which they propose to carry to a reserve fund.

(108) A copy of the balance sheet and report shall, seven days previously to the meeting, be sent to the persons entitled to receive notices of general meetings in the manner in which notices are to be given hereunder.

#### AUDIT

(109) Auditors shall be appointed and their duties regulated in accordance with sections one hundred and twelve and one hundred and thirteen of the Companies (Consolidation) Act, 1908, or any statutory modification thereof for the time being in force.

#### NOTICES

(110) A notice may be given by the company to any member either personally or by sending it by post to him to his registered address, or (if he has no registered address in the United Kingdom,

to the address, if any, within the United Kingdom supplied by him to the company for the giving of notices to him.

Where a notice is sent by post, service of the notice shall be deemed to be effected by properly addressing, prepaying, and posting a letter containing the notice, and unless the contrary is proved to have been effected at the time at which the letter would be delivered in the ordinary course of post.

(111) If a member has no registered address in the United Kingdom and has not supplied to the company an address within the United Kingdom for the giving of notices to him a notice addressed to him and advertised in a newspaper circulating in the neighbourhood of the registered office of the company shall be deemed to be duly given to him on the day on which the advertisement appears.

(112) A notice may be given by the company to the joint holders of a share by giving the notice to the joint holder named first in the register in respect of the share.

(113) A notice may be given by the company to the persons entitled to a share in consequence of the death or bankruptcy of a member by sending it through the post in a prepaid letter addressed to them by name or by the title of representatives of the deceased, or trustee of the bankrupt, or by any like description, at the address, if any, in the United Kingdom supplied for the purpose by the persons claiming to be so entitled, or (until such an address has been so supplied) by giving the notice in any manner in which the same might have been given if the death or bankruptcy had not occurred.

(114) Notice of every general meeting shall be given in some manner hereinbefore authorized to (a) every member of the company (including bearers of share warrants) except those members who (having no registered address within the United Kingdom) have not supplied to the company an address within the United Kingdom for the giving of notices to them, and also to (b) every person entitled to a share in consequence of the death or bankruptcy of a member, who, but for his death or bankruptcy, would be entitled to receive notice of the meeting. No other persons shall be entitled to receive notices of general meetings.

## APPENDIX B

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### REPORT OF THE COMMITTEE UPON THE AMENDMENT OF THE LAW UNDER THE COMPANIES ACTS, 1908 TO 1917

To the Rt. Hon. Sir ALBERT H. STANLEY, M.P.,  
President of the Board of Trade,

And to the Rt. Hon. C. ADDISON, M.D., M.P.,  
Minister of Reconstruction.

(1) On the 27th February, 1918, the Board of Trade were pleased to appoint a Committee "to enquire what amendments are expedient in the Companies Acts, 1908 to 1917, particularly having regard to circumstances arising out of the war and of the developments likely to arise on its conclusion, and to report to the Board of Trade and to the Ministry of Reconstruction." In accordance with the terms of our reference we have made a detailed enquiry into a number of questions which appeared to us relevant in this matter, and now report as follows—

(2) We issued in the first instance a number of questions to selected persons and bodies of persons competent to assist us in the matter. These included persons conversant with banking, commerce, law, shipping, accountancy, and the Stock Exchange. We received from them replies, all of which we have taken into consideration. Evidence has been given before us orally by 17 witnesses, whose names are given in the Schedule.

#### FOREIGN CAPITAL

(3) The question which lay in the forefront of our investigations and to which we attributed prime importance was that of the employment of foreign capital in British industries.

(4) The preliminary question whether it is desirable that foreign capital should be freely attracted to this country is one upon which there was little, if any, difference of opinion. The maintenance of London as the financial centre of the world is of the first importance for the well-being of the Empire; anything which would impede or restrict the free flow of capital to the United Kingdom would in itself be prejudicial to Imperial interests, and any legislation which would tend to impede or restrict the free flow of capital here by imposing restrictions or creating impediments ought to be jealously watched, lest in the endeavour to prevent what has come to be called "peaceful penetration" the normal course of commercial development should be arrested.

(5) It is to be borne in mind that at the conclusion of the war—if it should be concluded upon such terms as we hope and anticipate—there is no probability that the countries which are now the enemies

of the Allies will be those which will be in possession of capital looking for external employment. Outside the countries of the Allies it may be said, speaking generally and subject to exceptions of no great moment, that Europe will have little surplus capital to invest. The foreign capital which we have to contemplate will be capital flowing not from the Central Empires of Europe, but from other parts of the world, of which America may be the chief. To impose restrictions upon the influx of capital, aimed at our present enemies, with the result of deterring the flow of capital from (say) America, would be a policy highly injurious to the economic recovery and renewed prosperity of this country after the war. For these reasons we are of opinion that in all amendments of the law falling within the scope of our reference the expediency of the attraction of foreign capital should be steadily borne in mind, and anything which would have a restrictive or deterrent effect should, as far as possible, be avoided.

(6) At the root of the whole matter with which we are here concerned lies a question which is not one of company law amendment at all, but one of high political and economic policy. The alien may come here to trade in any one of three characters. He may come as an individual; he may come in conjunction with others as a firm; or he may come in the form of a corporation. The fundamental question is whether in any one of these cases he ought or ought not to enjoy the same commercial freedom as the British subject British-born; and, further, whether, if some aliens ought to come freely, other aliens who are now our enemies ought to have the same facilities. It does not fall within our province to enquire whether the traditional policy of this country to admit and welcome all who seek our shores and submit themselves loyally to our laws ought, in the case of some and what aliens, to be revised; whether any and what restrictions ought to be imposed upon the alien who, in any one of these three characters, seeks to come here; or whether discrimination ought to be made between an alien of one nationality and an alien of another. That is a question of high political and economic policy which it is not for us to determine. The question of naturalized British subject as distinguished from British subject British-born is, again, beyond our sphere. We may probably assume that, as regards aliens generally, there is no intention to change the traditional policy of the country, and that we have to enquire whether—that being so—any amendment of the law of joint stock companies is expedient having regard to circumstances arising out of the war. But, as regards aliens who are now our enemies, it may be that the British Empire may adopt the policy that a special stigma ought to be attached to the German and that neither as an individual nor as a firm nor as a corporation ought he, for a time at any rate, to be admitted to commercial fellowship or to any fellowship with the civilized nations of the world. The existence of these questions has greatly increased the difficulty of our task, for until the policy is known, it is not possible to say how the Companies Acts should be amended to give effect to it. It has thus become necessary for us to indicate our conclusions in alternative form according as the policy adopted in these respects is one or another.

(7) From the evidence before us and from deductions to be drawn

from some recent legislation, we recognize that there exists (in some quarters at any rate) a desire—probably a strong desire—to ascertain and record the extent to which aliens are active in commerce here. The legislation to which we refer is such as: (1) the Registration of Business Names Act, 1916 (which, although originating as a projected measure long before the war, yet was pressed forward as a war measure because disclosure of nationality was, as a consequence of the war, made a prominent characteristic); (2) the Companies (Foreign Interests) Act, 1917, whose purpose was to prevent the elimination from articles of association of provisions restricting the amount of capital which might be held by aliens; (3) the Companies (Particulars as to Directors) Act, 1917, whose effect was, amongst other things, to enforce disclosure of the nationality of directors; (4) the British Ships (Transfer Restriction) Acts of 1915 and 1916, which rendered void any transfer not approved by the Board of Trade of any share of a ship or even any mortgage of a share of a ship to a person not qualified to own a British ship or to a "foreign controlled company"; and (5) the Non-Ferrous Metal Industry Act, 1918, which we shall have to consider further when we come to the case of companies engaged in "key industries." Of these Acts, Nos. (4) and (5) were limited in time with reference to the continuance of the war, but Nos. (1), (2), and (3) were not.

In April, 1916, the Committee appointed by the Board of Trade to investigate the general question of trade relations after the war reported against imposing restrictions upon aliens becoming shareholders in British corporations but in favour of "definite information as to the nationality of the shareholders in every British company." The following is a quotation from paragraph (2) of the Report—

"We think, therefore, that it would not be well to use the two-edged weapon of restriction, especially in view of the fact that after the war it will be unwise to discourage foreign capital from coming freely to this country. But we think it desirable that the Government should be provided with definite information as to the nationality of the shareholders in every British company: We therefore recommend that every limited company should henceforth be required to include in its annual return to Somerset House a statement of the amount of its stock or shares held by or on behalf of aliens, together with a statement of their nationality."

The Committee, however, did not go on to state how the information as to nationality was to be secured.

On the other hand, Lord Balfour of Burleigh's Committee in December, 1917 (*see* Cd. 9035, paragraph 154), discouraged any attempt to secure this information.

Many of those who have made written replies to our questions, or who have given evidence before us, have expressed opinions in favour of disclosure of nationality by all shareholders and in some cases of limitation of the proportion which aliens may hold of the share capital of a company. Others, on the contrary, are impressed with the mischief which may result from restrictions whose tendency will be to deter the influx of foreign capital. In the recommendations which follow in this report we have sought to bear steadily in mind the considerations on the one side and on the other to which

we have directed attention. We have not hesitated to express our own opinion as to the way in which, in our judgment, the balance falls, but inasmuch as it is for the Legislature to determine whether the policy of complete commercial freedom, or that of alien restriction generally, or alien restriction as regards certain aliens, is to be preferred we have indicated what in each of these alternatives are the amendments of the law of Joint Stock Companies which we think should be adopted.

#### ALIEN SHAREHOLDERS

(8) If foreign capital is to be attracted here it follows that, so far as such capital is invested in or utilized for the industries of Joint Stock Companies, it must be represented either by shares in such companies or by debentures representing indebtedness by them, and that its employment must be controlled by Boards of Directors appointed from time to time by the owners of the invested capital. The question, therefore, is whether restrictions ought to be imposed upon the extent to which the control of the company shall be allowed to reside in aliens, either by reason of their holding a majority of the shares, or of the debentures, or by reason of their obtaining a majority upon the Board of Directors; and if so, how disclosure of their alien character is to be enforced.

(9) Before dealing with this question it will be well to point out difficulties which present themselves in the way of securing disclosure of nationality and ensuring that aliens shall not command the control, assuming that it is desirable to prevent their doing so. The law of trusts is firmly established in this country. If A be the registered holder of a share, he is not necessarily the beneficial owner. He may be a trustee for B. To enact that the registered holder must be a British subject effects nothing. For B may be an alien and an enemy. Suppose, however, that you enact that A, when his share is allotted or transferred to him, shall make a declaration that he holds in his own right, or that he holds in trust for B, and that both A and B are British subjects. There is nothing to prevent the creation of a new trust the next day, under which C, an alien enemy, will be the person beneficially entitled. Further, at the earlier date (the date of allotment or transfer) the facts may be that A (a British subject) is trustee for B (a British subject), but that B (unknown to A) is a trustee for C, an alien enemy. The fact that B is trustee for C would be purposely withheld from A, and A's declaration that he was simply trustee for B would be perfectly true. To require that A should make a declaration at short intervals (say once a month), or that A, B, C, and so on, should all make declarations would be, of course, so harassing and so detrimental as to be as matter of business impossible. The only effectual way of dealing with the matter would be by a provision that the share might be forfeited, or might be sold and the proceeds paid to the owner, if an alien should be or become beneficially entitled to or interested in the share. Such a provision does not in the general case commend itself to us as practical or desirable.

(10) Similar difficulties arise in any endeavour to control the nationality of the Board of Directors. It is easy, of course, to ensure that they shall all be, or that a majority of them shall be British subjects. But there is no means of ensuring that their

actions shall not be controlled by aliens whose nationality is not disclosed.

(11) Having pointed out these difficulties, we approach next the question of policy. Bearing in mind the sources from which, as indicated above, foreign capital may after the war be expected to come—

I. Is it desirable to legislate in the direction of forbidding the employment of foreign capital here in Joint Stock Companies unless some such provisions as the following are satisfied—

(1) That there shall be disclosure of the alien character of the foreign owner ;

(2) that not more than a certain proportion of the company's shares shall be held by aliens ;

(3) that the Board, or a certain proportion of the Board, shall not be alien ; and

II. Is it desirable to discriminate between one alien and another, and to legislate in that direction in the case of certain aliens and not of others ?

In our answer to these questions we find it necessary to discriminate between different classes of companies, and we divide them into—

*Class A.* Companies generally not being companies within classes B and C.

*Class B.* Companies owning British shipping ; and

*Class C.* Companies engaged in " key " industries.

#### COMPANIES OF CLASS A

(12) In the case of companies generally (Class A) we recommend that no restrictions at all be imposed. We think that, bearing in mind the sources from which an inflow of capital is to be anticipated and encouraged, the balance is largely in favour of the absence of restrictions, even although it involves non-disclosure of alien ownership. If there are restrictions, there must be disclosure of alienage, and the requirement of such disclosure might be thought to imply a stigma which in the case of our friends would be injurious. We have elaborated below a scheme of enforcing disclosure if that policy seems to the Legislature to be right. It is necessarily detailed and laborious ; it puts difficulties in the way of investment in English securities, whether by British subject or alien. It would supply no doubt to the Board of Trade useful information as to the extent of foreign investment in English industries. But the price paid for the advantage would, we think, be too great. It is, after all, if adopted, a scheme which can be evaded, and must to render it effectual be supported by consequences which should be imposed upon evasion. Simplicity and the absence of possible legal pitfalls are essential to free commercial development. We think the true policy is complete freedom so far as the law of Joint Stock Companies is concerned. Our recommendations go the length of allowing complete freedom as to the nationality both of the corporators and of the Board. They would allow, for instance, American capitalists to come here and establish themselves as a British corporation in which all the corporators and all the directors were American, and so of every other nationality.

(13) We would make no discrimination, so far as the law of Joint Stock Companies is concerned, between aliens of different nationality. For if there is to be such discrimination there must be the machinery of disclosure, involving as we think a deterrent effect, acting prejudicially in the case of all investors. This is, however, a large national question which, as we have said, it is not for us to decide. If any such discrimination were adopted we think that at any rate it should be limited to some short period, say, three or five years after the conclusion of the war.

#### *Disclosure*

(14) We turn next to the contingency that the Legislature may upon the question which it is not for us to determine consider that alien restriction is the policy to be preferred : that legislation should follow the lines which we trace in the recent statutes to which we have referred. In this case we submit the following scheme as a possible means of giving effect to that policy.

(15) For reasons already given it is not possible efficiently to ensure full disclosure, but the following suggestions would, in the absence of deliberate and intentional evasion (which would be quite possible), meet the point and in the large majority of cases would disclose the extent of alien interests and control—

(a) Every allottee of shares upon allotment and every transferee upon transfer should be required to make a declaration disclosing his nationality and whether he is the beneficial owner of the shares, and, if not, for whom he is trustee, and what is the nationality of the beneficial owner, and should undertake within a limited time, after any change in the beneficial ownership, to communicate the new facts to the company. In default of compliance with the above, the shares should, at the option of the company, either (1) be liable to sale by the company and the holder be entitled only to the proceeds; or (2) be liable to forfeiture and the holder entitled to receive payment from the company of ten per cent less than the market value of the share, or, if there be no market value, then ten per cent less than the value at which the share would be taken for *ad valorem* stamp duty if it were the subject of transfer. In case the company made default in exercising its power the Board of Trade should be authorized to require the above sale to be made.

(b) Every director, upon coming into office, should be required to make a declaration disclosing his nationality and stating whether in his office he is wholly free from the control or influence of any alien, and if he is not so free stating by whose directions or under whose control or influence he is to act and what is the nationality of that person, and should undertake within a limited time after any change in that state of things to communicate the facts to the Board and procure a statement of the facts to be entered in the Board Minutes. Any breach of these obligations to be visited with a penalty which should be severe.

(c) The company should be required to enter in the register of members, against the name of every registered member, his nationality as disclosed by the declaration. In the case where the registered member is not the beneficial owner, the company



should be required to record, not in the register but in another book, the nationality of the beneficial owner as disclosed by the declaration, and, as regards the latter book, to record the nationality of any new beneficial owner when and as disclosed by the registered member. These particulars should be required to be included in the annual list under Sec. 26 of the Act of 1908. That list would thus become not a list of members only but a list of members with the addition of beneficial owners. The company should, further, be required to add to the annual list a summary of the result as regards nationality, showing (1) as regards registered members, how many are British subjects and how many shares they hold, and how many are aliens and how many shares they hold, sub-dividing the number of the aliens and their holdings under their respective nationalities; and (2) as regards the registered members who are British subjects: (a) how many of them are the beneficial owners and how many shares they hold; and (b) as regards the rest, what are the nationalities and holdings of the beneficial owners.

(d) The particulars as to directors to be introduced into the annual list by enlargement of the requirements of Sec. 26 (l) of the Act of 1908.

(e) Existing shareholders should be brought in by the machinery presently suggested in paragraph 33.

(16) The clauses should be so worded as that it should not be necessary to disclose mortgages of shares. It is true that this opens a door to evasion; but it is necessary not to interfere with commercial freedom in procuring loans upon shares.

[NOTE. The above recommendations do not cover the case of a company influenced or controlled in fact by its debenture holders. The existence of bearer debentures would make it impossible to extend the obligation of disclosure to debentures. We do not see our way to suggest the discontinuance of bearer debentures.]

(17) If this or some similar scheme were adopted, it would form the basis of any principle which might be accepted as regards alien holdings, e.g. that aliens (of certain nationalities) should not hold shares at all, or should not hold more than a certain proportion, or that aliens (of whatever nationalities) should not so hold, or that the directors or a majority of the directors should not be of alien (or some defined alien) nationality, or under alien control.

(18) We have already pointed out that any scheme of disclosure can be evaded by concealing the identity of the ultimate beneficial owner and, consequently, concealing his nationality. Further, if our recommendation of complete freedom and no enforcement of disclosure of nationality is adopted, it is, of course, *à fortiori*, possible that alien (possibly enemy) corporations may be established here. A suggestion has been made before us which we think it desirable to detail. It would, we think, cover the difficulties arising from both these points. Nevertheless, for reasons which we will assign, we do not recommend it for adoption. The case is supposed of a corporation British in form but alien in fact, whose alien nationality is effectually concealed and whose commercial activities are prejudicial to national interests. It is a corporation, let us suppose, which is using the advantages of British corporate life in a manner injurious to the national interests of this country. It may be

seeking to control "key" industries; it may be seeking to injure British trade and to further unfairly the interests of the trade of another country by "dumping" its goods; it may be seeking to make "corners" to the injury of British and the furtherance of alien interests, and so on. There ought, it is said, to exist the means of stopping this. The suggested means is as follows—

Establish a permanent commission framed something upon the model of the Railway Commission. The tribunal to consist of, say, five members, four commercial and one judicial—of whom the judicial member shall be president. The four members could either be permanent or selected from time to time from a panel. Give this tribunal jurisdiction to enquire *whether any corporation is by reason of the nationality of the incorporators or of the persons interested in or carrying on or controlling the business of the corporation a company whose existence or commercial operations is or are for economic or political reasons injurious to the national interests of the British Empire or any part of the British Empire*, and if that be found to be the case to make an order to wind it up. The tribunal to be clothed with a very full discretion and to be entitled to act upon inferences reasonably drawn upon the principle that one of the parties before the Court knows all the real facts and has the means of displacing suspicion if suspicion arises, and that if he does not do so the Court is entitled to assume against him that suspicion based upon some reasonable grounds is well founded. The tribunal should be at liberty to infer who are the persons interested and what is their nationality from facts which justify an inference against them, although strict proof (which they could but do not supply) is wanting and the circumstances render it impossible for their adversary to give strict proof. The decision of the tribunal to be final and not subject to appeal.

(19) If such a tribunal were constituted it would be essential to insure that it should not be capable of being used by one trader to injure the business of a rival trader (even though the rival be an alien) because rivalry in his business was injurious to his pocket. The words "for economic or political reasons" are intended to effect this. Further, it would be essential that access to the tribunal should be closely guarded as, for instance, that the right of application should be confined to the Attorney-General or any person interested who obtained the fiat of the Attorney-General.

(20) But safeguard it how you will our opinion is that the existence of such a tribunal would so operate as a deterrent to the influx of foreign capital as that its possible utility in some future state of circumstances is not comparable as an advantage with the disadvantage which would result from the fact of its existence. Suppose that citizens of some foreign nation most friendly to Great Britain contemplated the establishment of a great industry in this country, they would naturally regard it as a possible contingency that friendly relations might unfortunately at some future time be disturbed, that "national interests" might require something at present unexpected but nevertheless possible, and that they might fall under the jurisdiction of this tribunal, and for this reason might abandon their project. We think that any such question had better be left to legislation which may be found to be appropriate when the particular case arises.

## CLASS B.—COMPANIES OWNING BRITISH SHIPPING

(21) The policy of the Merchant Shipping Act, 1894, as disclosed by ss. 1, 9 (v), 25, 28, 57, 69, 71 and 76, appears to be that British ships shall be owned only by natural-born British subjects or persons naturalized, etc., and although British corporations are added by Sec. 1 (d), the inference is that the statute has overlooked the fact that a corporation, British by registration in this country, may in fact be alien in respect of the persons who are holders of or are beneficially interested in its shares. If the policy of the Act is such as we have stated it would in order to cover this point be necessary to amend the Act by adding words at the end of Sec. 1, sub-section (d) so that it shall read "*Bodies corporate established under and subject to the laws of some part of His Majesty's dominions and having their principal place of business in those dominions and being bodies corporate of which all the corporators and all the persons beneficially entitled to or interested in the shares of and interests in the corporation are persons falling within some one of the above sub-clauses (a), (b), and (c).*" The words added are printed in italics.

The result would be to leave naturalized British subjects and persons made denizens by letters of denization within the privileged class. This is a point with which we do not deal as we are not concerned with the general and large question of naturalization.

(22) It will be observed that the above words hit the case of every person, however remote he may be from the registered shareholder in the corporation in question. If the shares are registered in the name of A, who is trustee for B, and B is trustee for C, and so on, and if C or any subsequent letter of the alphabet is not a British subject the corporation in question could not, if those words were introduced, hold a share in a British ship.

(23) The British Shipping (Transfer Restrictions) Acts, 1915 and 1916, adopt and enlarge the above policy and extend it to mortgages of shares in ships. These were excluded by Sec. 34 of the Act of 1894.

(24) We have heard in evidence that individual ownership, as distinguished from corporate ownership, of British ships is, in the great shipping lines at any rate, now almost unknown. Ninety or even ninety-five per cent of British ships we are told are now owned by corporations. The question of corporate ownership is, therefore, of great importance.

(25) While we proceed to express the views which we have formed in the matter, we at the same time recognize that they may involve a departure from the policy of the Merchant Shipping Act. In this connection attention may be drawn to the recommendations in this matter contained in paragraphs 330, 331 of a recently published Report to the Board of Trade (Cd. 9092) of a Committee, appointed by Mr. Runciman on 27th March, 1916, consisting of shipowners and shipbuilders specially conversant with the subject.

(26) We are satisfied upon evidence that the total exclusion of aliens from ownership of British ships is not essential for national safety and as a commercial matter is not expedient. A British line may be willing and desirous that its agent in a foreign port (being perhaps an alien) should have an interest in the success of the line. Or a British line may wish to make a working arrangement

with, say, an American line under which each shall have, say, a one-fifth interest in the undertaking of the other. If the aggregate ownership by aliens does not confer more than 20 per cent of the power of control they can neither carry an ordinary resolution nor defeat (much less carry) a special or extraordinary resolution. As regards the constitution of the Board, we are assured that 80 per cent of the power of control can always secure the existence of a Board which will be representative of such nationality as that 80 per cent approve. We therefore think that in these companies it would be sufficient to ensure that not more than 20 per cent of the power of control should be in alien hands. We are not prepared to say that in this Class B there should be the same freedom as in Class A. We think that there should be this limit of 20 per cent—that not more than 20 per cent of the share capital should be held by aliens, and that those shares should carry no more than 20 per cent of the voting power. Alternatively, we think, and indeed we should prefer, that the alien holdings should carry no vote at all—but this is a point of detail deserving further consideration.

(27) It follows that in this Class B there must be disclosure of nationality and that allotment or transfer in breach of the limit should be forbidden and if made should be inoperative. Disclosure should be enforced in the manner detailed under the head of Class A in paragraph 15 of this Report, clauses (a), (b), (c), (d). Bearer shares must necessarily be forbidden.

(28) Existing ownership in excess of the limit may, we think, be safely left undisturbed for the present.

(29) An exemption from this legislation is necessary as regards certain ship owning corporations. There are corporations which own shipping as a subsidiary part of their undertaking, but which are not within the spirit of the veto which we seek to impose. Some of them are incorporated under the Companies Acts, others are not. The L. & N.W. Railway Company, the S.E. & C. Railway Company and other like undertakings own ships. Some gas companies and some commercial companies own colliers. Some of these are companies incorporated under the Companies Acts. There is no intention of suggesting legislation which shall prevent, say, the L. & N.W. Railway from having alien shareholders beyond a certain limit. There should be legislation, therefore, to the effect that a corporation which owns shipping as a subsidiary and comparatively unimportant part of its undertaking may, with the licence of a defined authority, be taken out of Class B and put within Class A if its ownership of British shipping is confined within limits stated in the licence. The authority should be the same for all corporations whether under the Companies Acts or not—say, the Board of Trade.

[NOTE.—If our view in the above respects be adopted, the amendment above suggested in Sec. 1 of the Merchant Shipping Act, 1894, would not be made, but would be replaced by an amendment giving effect to the altered policy. This would be done by reference in the Shipping Act to the proposed new clauses in the Companies Act.]

#### CLASS C.—COMPANIES CARRYING ON “KEY” INDUSTRIES

(30) We shall not attempt a definition of a “key” industry. The idea intended to be conveyed by the expression is fairly well known,

and it would be possible by statute to define in general terms the characteristics of a "key" industry and then remit it to a defined authority, say, the Board of Trade, to determine in each particular case whether the industry is a "key" industry. We shall assume that this is done and that the question is as to any amendments in Company Law expedient to deal with a company carrying on a "key" industry when the fact that it is carrying on a "key" industry has been established.

(31) The typical case that has arisen is that dealt with by the Non-Ferrous Metal Industry Act, 1918. It may be thought expedient to leave any other case of key industry to be dealt with in like manner by an Act of Parliament *ad hoc*. But for our purpose we must assume that this is not so and that we have to say how it should be dealt with by general legislation amending the Companies Acts.

(32) The question whether a company is one to carry on a "key" industry could seldom or never arise at the time of its registration. The modern memorandum of association includes such a multitude of objects that a "key" industry might be *intra vires* of almost any company. The question would arise when the company is carrying on business.

The Board of Trade we think should be empowered to make at any time an enquiry whether a company in Class A is carrying on a "key" industry or not, and if it finds that it is the company should fall out of Class A and into Class C, with the result that the following provisions shall apply—

(33) (a) The company shall, at the direction of the Board of Trade, by notice require every registered member to make a declaration such as under the disclosure procedure which we have suggested under Class A (*see* paragraph 15) he would have had to make if he were at the date of the notice about to receive an allotment or become a transferee, and in default the member shall be excluded from voting and receipt of dividend as in Sec. 4 of the Non-Ferrous Metal Act.

(b) The company shall, at the direction of the Board of Trade, by notice require the holders of share warrants to bearer to surrender their warrants for cancellation and to have their names entered in the register and to make a similar declaration, and in default the share warrant holder shall be excluded from voting and receipt of dividend as above.

(c) All subsequent allottees and transferees shall be subject to the obligation of disclosure as suggested under Class A. (*See* paragraph 15.)

The above will ensure disclosure (subject, of course, to the possibility of evasion as before).

(34) The limits of 20 per cent recommended in the case of merchant shipping should then be made applicable, and if the 20 per cent limit has in fact been exceeded the Board of Trade should be empowered to apply to the High Court for an order for sale of so much of the share capital as will reduce the alien holding within the limit with a direction that the Court shall so far as reasonably possible take the shares for sale rateably from the alien holders.

(35) If companies of Class A were conceded the freedom which we recommend in paras. 12 and 13, it would be easy to devise machinery

by which any particular company in that class could, if circumstances rendered it desirable, be taken out of Class A and brought into Class C. We recommend that legislation should take that form.

#### INCORPORATION BY ALIENS

(36) The reasoning which leads to the conclusion that aliens should be allowed the freedom which we recommend leads also to the conclusion that it is not expedient to prevent or to seek to prevent aliens from incorporating companies in this country. They cannot, in fact, be efficiently prevented from so doing, for by obtaining the signature of British subjects to the memorandum of association they can achieve their object and the identity of those who stand behind the subscribers can, as above explained, be effectually concealed.

#### NAME OF THE COMPANY

(37) We have a further recommendation to make in the direction of disclosure. The name by which a company is called is from many points of view a matter of no moment. But if a name be used which conveys a misrepresentation of the nationality of the company it may have a wide commercial effect. We think that there should be machinery for controlling the name employed so that a representation of nationality where the company is not British shall as far as possible be prevented. For this purpose we recommend that—

(a) When application is made for registration of a new company and the name suggested states or conveys expressly or by implication British nationality the Registrar may require to be satisfied upon the question of nationality and may refuse to accept the name unless the articles of association contain clauses providing to the satisfaction of the Registrar or of the Board of Trade that the new company will in fact be British. This would apply not only when the word British or some similar word forms part of the name, but to all cases in which an implication of British nationality arises which in the opinion of the Registrar would be liable to mislead. The question whether the proposed name is liable to mislead or not should be left largely to the discretion of the Registrar. For the question whether a name will mislead or not is necessarily matter of opinion.

(b) When an existing company is trading under a name which states or conveys expressly or, in the opinion of the Registrar, by implication British nationality and the Registrar is satisfied that the nationality is not British, he may (subject to a right in the company to apply to the Court) call upon the company to change its name to an approved name, and if within a limited time the company fails to do so the Registrar may (subject to the like right) by order under his hand change the name to such name as he approves, and that name shall thenceforward and until some further authorized alteration of name be the statutory name of the company.

[NOTE.—There are cases in which the Registrar has already assumed that he has a power of control over such words as "Royal" or "Imperial." If legislation such as we suggest is adopted, it

should be so expressed as to give the Registrar a discretion in that class of case.]

(38) Considerable discretion should be left to the Registrar, for it is not every case in which a name conveyed by implication that the company was British in which it would be right to interfere.

#### BEARER SHARES

(39) Disclosure and bearer shares are mutually inconsistent. If a policy of disclosure is adopted bearer shares must go.

If, however, disclosure be negated the opinion of those whose evidence we have received as to the expediency of bearer shares is divided. The balance is in favour of retaining them. By British investors they are not largely held, but British investors seem to be inclining towards them. To the foreign investor (including the American investor), they seem to appeal strongly. They attract the small Continental investor, and reach him through his local bank, which is probably a branch of or in correspondence with a London bank. The system is such as the following: A bank domiciled in London has branches in many places abroad or has correspondents who are local bankers in places abroad. The foreign local bank is in touch with the small investor, who is perhaps interested in a particular industry such as carried on by the British company which issues the bearer shares. Share warrants in the company are taken up by or for the small investors; they are all, in fact, placed in the control and probably in the possession of the bank in London. The result is that that bank is for all practical purposes the undisclosed member of the company in respect of the aggregate amount of the foreign holdings and is in a position to exercise the voting power. We think that bearer shares should be maintained. We have not gathered any sufficient reason for abolishing them, and the reasons in their favour are weighty. If control should become necessary the machinery would be supplied by the insertion of provisions that the company may and upon notice from the Board of Trade shall call in the share warrants for cancellation and their right to vote and to receive dividends shall be suspended until the share warrant has been superseded by registration.

#### FRESH ISSUES COMMITTEE

(40) In answer to a question whether after the war some restriction should be imposed upon the issue of capital similar to that now exercised by the Fresh Issues Committee at the Treasury we have received replies almost without exception in the negative. Such restrictions would be quite out of keeping with the freedom which we think desirable.

We pass now to questions not directly arising out of the war or of the developments likely to arise on its conclusion.

#### ISSUE OF SHARES AT A DISCOUNT.—ASSESSMENT OF SHARES

(41) More than a quarter of a century ago Lord Macnaghten, in *Ooregum Company v Roper*, 1892, A.C. 145, speaking of the Companies Act, said: "The dominant and cardinal principle of these Acts is that the investor shall purchase immunity from liability beyond a certain limit on the terms that there shall be and remain

a liability up to that limit." The principle thus stated is quite clear, and had it been adhered to many difficulties which are now well nigh insuperable would not have arisen. The legislature has, and the Courts have—if it be not a contradiction in terms—adhered to the principle but not maintained it. The development of the law has allowed payment to be made upon shares by the transfer of property which need not be shown to be in value the pecuniary equivalent of the amount due upon the shares. Payment of commission to a person in consideration of his subscribing for shares or procuring subscriptions for shares has been allowed by Statute. But it has never in so many words been provided that the allottee of a £10 share may satisfy all liability upon the share by paying, say, £1. Neither has the Legislature said in so many words that after the £10 has been paid the company may return it or part of it to the shareholder except by the statutory proceedings for reduction of capital.

(42) The question we have to consider arises when the law stands in the above illogical and indefinite form. It is of the following nature: A company has been formed with a capital of, say, £100,000 in £10 shares. Assume that they have all been taken up and all paid in full in cash, but that £50,000 of the cash has been lost and the market value of the full-paid share is, say, £5. The company wants more capital, but obviously in that state of facts cannot obtain subscribers for new £10 shares on the terms that they shall pay £10. Two courses may be possible if the law allowed them—

(a) The company could obtain subscribers for new £10 shares upon the terms that upon payment of £5 there should be no further liability. This would be an issue at 50 per cent discount.

(b) If the company could impose on the existing holder of a £10 share that he should be liable for a further £5 per share on his £10 share, with the alternative that if he would not accept that liability he should be valued out and lose his share, receiving payment of such sum, if any, as would be attributable to his share if the company were wound up, then the company might be able to obtain a new subscriber for a £10 share on the terms that he should pay £10 for it. This would be a case of assessment upon the existing shareholder.

(43) Each is a case in which new terms are imposed upon the existing shareholder against his will. His bargain was to contribute £10 to a common stock: to risk its employment in a defined trade until the will of the statutory majority of the shareholders or the intervention of the Court at the instance of shareholders or creditors stopped the trade: and to take his chance of profit from that employment. He was never to pay any more and the adventure was to continue until the money was all lost or the undertaking was stopped by a winding up. If any new adventure came in they were to come in on the statutory terms of liability up to the nominal amount of the share. Is it desirable to alter the law? The question is one of expediency.

(44) The evidence before us leads to the conclusion that it is desirable to alter the law. But if that course is adopted it is necessary to consider another matter. If shares are to be allowed to be issued at a discount so that the full nominal capital will never be received ought payment of dividends out of capital still to be



forbidden so that the amount in fact received in respect of capital must be maintained intact except so far as it is dissipated by loss?

And yet another question: If the course proposed is adopted ought the present statutory scheme for reduction of capital to be varied and how?

Taking these several questions in order we are of opinion as follows—

(45) **ISSUE OF SHARES AT A DISCOUNT.** The original principle as stated in Lord Macnaghten's words has been already so infringed that it cannot be said to continue to exist as a cardinal principle. The evidence before us is that commercially the issue of shares at a discount is desirable. There is we agree no principle in this. It is a concession to commercial experience. Principle, however, has as instanced above already been abandoned, and issue of shares at a discount is but accepting in practice that which has already been conceded in fact by allowing payment of commission in consideration of a person subscribing for shares.

(46) At the same time we think that the amount of discount should be so controlled as that the provisions of the Act in respect of capital shall not be illusory. There should be a statutory limit to the discount allowable, and if the disease is so deep-rooted as that the statutory limit is not sufficient for the purpose the matter should be left to winding up. For these purposes the issue of shares at a discount should be controlled as follows. It should not be allowed at the beginning or at the earlier stages of a company's career. It should be allowed only when the company's issued share capital is at a discount, and a maximum percentage of discount should be fixed. We recommend that five years after commencement of business shall be the earliest date for issue, and that the price shall not be lower than five per cent below the market value of the similar existing shares in issue if there be a market price, or five per cent below the price at which the existing shares would upon transfer be taken for *ad valorem* stamp duty under the Stamp Act if there is no market price, and that the discount shall never exceed 50 per cent. Thus, if the £10 share stood in the market at £6 the price should not be lower than £5 14s., that is to say the discount should not exceed £4 6s., and in no case should the discount exceed £5. Further there should be ample provision for complete publicity. The balance sheet, the annual statement, and every prospectus should state in plain terms the discount which has been given. Sec. 89 of the Act of 1908 should be so amended as to exclude commission payable to a person in consideration of his subscribing for shares and to confine the word "commission" to meaning either brokerage which is a payment made for services rendered or underwriting commission which is a payment made for a guarantee given.

(47) **ASSESSMENT.** The object which is sought to be attained by assessment is now attained by what is called reconstruction. Reconstruction is a proceeding by which the company is put into liquidation and the assets are sold to a new company formed for the purpose with a share capital so arranged as that such of the shareholders as assent take shares in the new company with a further liability, and those who do not are paid off in liquidation,

The objections to this mode of procedure are principally first that it is very expensive, and secondly that a winding up always creates commercially a certain amount of prejudice. The expense arises principally from the fact that new revenue duties have to be paid exactly as in the case of a new company, although in fact the transaction really consists in rejuvenating an old one; and that a very large amount of clerical work is involved. If issue of shares at a discount is to be allowed we see no objection to allowing assessment. It sins against the original principle in a manner which is the converse to that in issue of shares at a discount. The latter allows a reduction, the former allows an increase in the amount which according to the original principle of limited liability was to be the member's limit of liability. As matters stand assessment is but achieving in another and a cheaper form that which can be done already.

(48) For the protection of the minority of shareholders, however, we recommend that there shall be the following restrictions. A power to assess shares should not be allowed to be included in the memorandum or articles of association of the company either originally or by alteration of the articles. An assessment should only be made under the authority of a special resolution approving the particular assessment proposed. It should further be provided that every special resolution must mention a sum per share to be paid in cash to such members as dissent and that the dissentient member shall be entitled at his option either to accept that sum or to demand an arbitration to determine what sum shall be paid with a further provision that there shall be only one arbitration and that in arbitration the dissentients shall appear together, but with power to any dissentient to appear separately at his own expense, or if the arbitrator shall so order at the expense of the company. The costs of the arbitration to be borne as the arbitrator shall direct.

#### REDUCTION OF CAPITAL AND PAYMENT OF DIVIDENDS OUT OF CAPITAL

(49) In the above paragraphs 44 to 47 we have gone as far as we think it expedient to go. The law as to reduction of capital and as to payment of dividends out of capital should, we think, be maintained as at present.

(50) Opinions have been expressed before us in favour of a principle which would abandon altogether the nominal amount of a share in a company limited by shares, and would even allow registration of a company with shares carrying no liability. The idea is that the company might sell a share in its undertaking for such sum as an interest in the company might command and that its capital fund should consist exclusively of the aggregate sum obtained by the sale of such interests as a share represents. This they contend is but the logical outcome of the condition to which the law has come by allowing issue of paid-up shares against property not of value equivalent to the nominal amount of the shares—commission for subscribing for shares—and issue of shares at a discount (if issue at a discount should now be openly allowed). They further advocate the allowance of payment of dividends out of capital, safeguarded only by provisions which would allow of the recall

of capital so distributed if within a limit of time the money were required for payment of debts.

(51) Your Committee are not prepared to accept any such radical alteration of the law. The present basis of limited liability in a company limited by shares is that the liability of the member is to be limited to the amount if any unpaid on his shares. (See Sec. 2 of the Act of 1908.) If the member is to be under no liability or the amount paid on his shares is not to constitute and to be retained (subject only to loss incurred) as capital, the law must be made to rest not upon any amendment of the existing Acts but upon legislation starting from a different point of departure and proceeding upon wholly different lines.

(52) In the recommendation which we have made in this Report we have gone as far in the direction of meeting the views above indicated as we think it possible to go if the fundamental principle of the present law is to be observed at all. And, as we have already stated, we should not have been prepared to go so far but for the fact that the original principle of the Act of 1862 has already been so largely ignored as that a further concession to commercial opinions will probably do no harm and would in fact only openly permit that which under the law as it at present stands can in fact be achieved.

#### MEMORANDUM OF ASSOCIATION

(53) The Companies Acts require that the memorandum of association of a company shall state "the objects of the company." It was laid down more than forty years ago in *Ashbury Railway Carriage Company v. Riche*, L.R. 7, H.L. 653, that the memorandum of association is the company's charter and defines the limitation of its activities and the destination of its capital. It is perhaps not matter of surprise that under these circumstances commercial men looked to see whether in the memorandum of association were to be found words justifying the particular commercial transaction into which they contemplated entering. But in so doing they forgot that that which the Act required the memorandum to state was "the objects of the company," and not the powers by the exercise of which those objects were to be attained. For instance, the object of the company might be to open and carry on an hotel at Dover. To achieve that object the company must have power to hold land to erect a building, to buy furniture, to employ a staff of servants, and so on. But none of these were objects. They might and probably would further want to borrow money, giving very likely a mortgage on the property. But borrowing was not their "object"; it was an act which they would do if they could in order to achieve their object, viz., to run their hotel as a commercial success. However, an evil practice grew up of crowding into the memorandum of association words that would cover every conceivable act which the corporation could under any circumstances desire to do. Objects were buried and concealed in an accumulated mass of powers. The resulting mischief was twofold. The intending investor who ought to have been informed with reasonable clearness as to what was the trade in which his money was to be risked could often learn nothing except that his money might be used for any conceivable purpose. And the intending creditor was

deprived of the advantage of knowing what his intending debtor could and could not do in the employment of its capital.

(54) This abuse reached its climax in the case of the Anglo Cuban Company, recently argued in the House of Lords under the name of *Cotman v. Brougham*. The memorandum of association of the company there in question after 30 paragraphs of the wildest kind, very few of which defined objects at all, concluded with a clause to the effect that the objects set forth in any paragraph should not be restricted by the terms of any other paragraph and that none of the paragraphs or the objects specified in them should be deemed subsidiary or auxiliary to the objects mentioned in the first paragraph. Having regard to the provision in Sec. 15 of the Act of 1908 that the Registrar's certificate of incorporation is conclusive evidence that all requirements of the Act in respect of registration and of matters precedent and incidental thereto have been complied with and that the association is a company authorized to be registered and duly registered under the Act, the House of Lords was compelled to assume that this was a memorandum of association which stated "the objects of the company."

(55) We recommend that the Act be amended by providing that the memorandum of association must state the objects but must not state the powers of the company, that such powers of the company as it is thought necessary to state shall be stated in the articles, and that there should be introduced into the Act a section providing that every company shall have certain powers as detailed in the section except in so far as the articles of association exclude them. The power of borrowing, of subscribing for shares in other companies, of purchasing other businesses and a number of similar and other powers would then find their proper place, and the memorandum of association would be reduced to its proper function in defining the trade of the company or other the object which it is to pursue with a view to earning profit.

#### REGISTRAR'S CERTIFICATE

(56) As the law at present stands the Registrar's certificate is conclusive upon the matters mentioned in Sec. 17. This throws a very heavy burden of responsibility upon an official who has neither the time nor the means of being satisfied upon all the matters on which his action is to be conclusive. It is certainly of the first importance that when the company is about to contract engagements there should be no room for doubt whether it is a corporation or not. But we think the Act goes too far. If the requirements of the Act have not in fact been complied with; if (say) the association was not one authorized to be registered under the Act; if the so-called memorandum of association is not a memorandum of association such as the Act requires there ought to exist the means of questioning this provided that it can be done with justice to those who have dealt with the body as a corporate body. This can be achieved if the body be treated as a corporate body during its existence, but that existence can be brought to an end upon the ground that it never ought to have begun. We recommend that it shall be a ground for winding up a company that the requirements of the Act in respect of registration or of matters precedent or incidental thereto have not been complied with or that it was not

an association authorized to be registered under the Act, and that upon that application the Registrar's certificate shall not be evidence conclusive or at all. Lord Davey's Committee by para. 16 of their report in June, 1895 (C. 7779), recommended a clause making it a cause of winding up that a certificate of incorporation has been obtained by fraud, misrepresentation or mistake, or by a wilful violation of any provision of the Companies Acts. And they added to it a recommendation that there should be cause for winding up if the Court is satisfied that the company was formed or that its business has been carried on with the intent or in such manner as to defraud, defeat or delay the creditors of the company or of any other company or person, or for any fraudulent or illegal purpose. With these recommendations we agree.

(57) While it should be a ground for winding up that the requirements of the Act have not been complied with it should be left to the discretion of the Court to make or to refuse a winding up order on that ground according as it is or is not just and equitable that an order should be made. If, for instance, the defect does not go to the root of the matter or if the business and the position of the company are such as that it ought to be allowed to go on, or if creditors would be prejudicially affected by a winding up, the Court should have power to refuse an order and (if it thinks fit) to give validity to the invalid registration.

#### AUDIT AND AUDITORS' CERTIFICATE

(58) We have made enquiry into the question whether the law should be amended by requiring that the auditors must have some and what professional qualification. We do not make any recommendation to that effect. We have not traced any mischief which requires remedy in the matter.

(59) Sec. 113 of the Act of 1908 requires that the auditors shall report whether the balance sheet "is properly drawn up so as to exhibit a true and correct view of the state of the company's affairs according to the best of their information and the explanations given to them and as shown by the books of the company." We have made enquiry whether the words "and as shown by the books of the company" should be omitted and the certificate should be that the balance sheet exhibits "a true and correct view of the state of the company's affairs." We are without hesitation of opinion that it would be highly inexpedient indeed, we may say impossible, to require a certificate in that form. The decisions in *London and General Bank* (No. 2), 1895, 2 Ch. 673, and *Kingston Cotton Mill Co.*, 1896, 1 Ch. 331, 2 Ch. 279, have delimited with great distinctness the extent and limits of the auditors' responsibility. We do not think they can reasonably or profitably be extended.

#### DISCLOSURE OF PROFIT AND LOSS

(60) Sec. 26 (3) of the Act of 1908 provides that the annual summary required of every company other than a private company must include a statement in the form of a balance sheet, but the balance sheet need not include a statement of profit and loss. We have made enquiry whether a profit and loss account ought to be included. We do not recommend that it be required. As a commercial matter publication of profit and loss ought not to be required

in the absence of very strong reason, and we do not find that such reason exists. To require from a corporation a public disclosure of profit and loss which is not required from a firm or an individual gives an unfair advantage to a competitor in trade and does not commend itself to our judgment. But we think that it may reasonably and without public mischief be required that the statement in the form of a balance sheet to be included in the annual summary shall state the amounts or rates of dividend which have been paid since the last balance sheet or are proposed for payment as the result of the trading. And we recommend an amendment of the law to that effect.

#### PAYMENT TO DIRECTORS FREE OF INCOME TAX

(61) We have learned that there exists a practice in some companies of making the payments to directors *quid* directors free of income tax, including super-tax. Assume that a director's fees are to be £100 a year free of income tax and super-tax. The additional sum which he in fact is paid by reason of his being relieved of income tax is a sum not fixed but varying according to what his aggregate income from all sources may be. The rate demandable from him for income tax may be 6s. in the pound or may be some less sum. Further (and this is the mischief at which we point in particular) the super-tax of which he is relieved may vary in a very much larger degree. If his aggregate income is small there may be no super-tax demandable at all. If it be large the super-tax may be 4s. 6d. in the pound. The payments which the directors receive should be of an amount openly stated and plainly known without any necessity of computation to every member of the company. The sums payable to directors are in some cases large, so that the additional sum due to relief at the expense of the company from income tax and super-tax may be substantial. The shareholders ought to know what the directors' remuneration is. We recommend that payment to directors free of income tax or of super-tax shall be forbidden.

#### DISTINGUISHING NUMBERS OF SHARES

(62) Sec. 22 of the Act of 1908 requires that each share shall be distinguished by its appropriate number. The present system of denoting numbers attached to shares creates a very large amount of clerical work. Shares of very small nominal amount—not infrequently as low as a shilling, and very frequently as low as £1—are now common and this is true of very large concerns. The preparation and checking of transfers and the records in the company's books in such cases involve a large amount of clerical work. We have been pressed in evidence by gentlemen who represented the Institute of Secretaries to recommend that upon these grounds the distinguishing numbers of shares shall be abandoned. We are not satisfied that as regards fully paid shares—or even as regards partly paid shares—the distinguishing numbers are essential for any useful purpose. But we find that the Committee of the Stock Exchange and some of the banks wish to retain them (although others do not), while the Chambers of Commerce are divided in opinion. On the whole we do not in this state of opinion recommend that distinguishing numbers be abandoned.

## PRIVATE COMPANIES

(63) We have ascertained from the Board of Trade that (approximately not exactly) the total number of companies on the register is 66,000 and of these no less than 50,000 are private companies. These figures show and the evidence before us has shown that the private company has met a want. The principal attraction of the private company lies in the fact that the company need not make the annual statement required by Sec. 26 of the Act of 1908. It avoids the necessity of an annual publication of facts from which the success or failure of its trading may be ascertained. The private company might no doubt be used for purposes of fraud, but there is no evidence before us that it is so used. It has been on its trial for about 10 years. We think it has up to the present justified its existence and should be left undisturbed.

## GENERAL OBSERVATIONS

(64) In addition to the several matters upon which we have above submitted observations and recommendations a number of other matters have been the subject of evidence before us and have been considered and discussed by the Committee.

Evidence has been given before us upon such subjects as whether a company should be restricted in respect of borrowing, whether floating charges upon all present and future assets should be allowed whether the requirements of the Act as regards prospectuses are sufficiently exacting, whether those requirements should be extended to foreign companies, whether a vendor to the company should be allowed to take shares or debentures in payment, and if he takes shares whether he should be precluded from selling them for some and what time, whether promoters in the form of corporate bodies should be allowed, whether investigation at the public expense of the affairs of a company where there is reason to suspect fraud ought to be facilitated, whether incorporation by registration should be deferred until some defined amount of capital shall have been subscribed and paid up in cash. Most of these were exhaustively considered by Lord Davey's Committee in 1895. Upon none of these do we find that any sufficient grievance or mischief exists to call for any alteration at the present time of the existing law. Some are already controlled and much better controlled by regulations of the Stock Exchange than they could be by legislation. One which was tried in the form of provisional registration was after experience abandoned in 1856, and Lord Davey's Committee reported against it in June, 1895 (*see* para. 24 of their Report, C. 7779).

We have received from several sources, such as (1) a memorandum from the Registrar of Joint Stock Companies, (2) suggestions from the Official Receiver in Companies Liquidation, and (3) correspondence from persons and bodies conversant with and interested in the branch of the law with which we have to do, numerous suggestions as to points, some of minor others of greater importance, in which it is said that the Companies Acts might with advantage be amended.

(65) We have considered that it is not within the spirit of the reference under which we are sitting to deal with matters such as these, or at any rate, that we ought not to delay this report in order to investigate them. Our primary duty we have taken to be to

enquire and report as to amendments expedient having regard to circumstances arising out of the war and of the developments likely to arise on its conclusion. We have given these words—prefaced as they are by the word “particularly”—a liberal interpretation, and have gone into some matters which appeared to us of importance sufficient to justify our including them. But we have not thought it right to go into a general enquiry as to amendments in the law which do not bear upon the exceptional state of circumstances with which we are asked to deal.

(66) We desire to express our appreciation of the zeal and ability shown by Mr. W. Walter Coombs in the discharge of his duties as Secretary to the Committee.

We have the honour to be

Your obedient Servants,

WRENBURY.  
A. S. COMYNS CARR.  
FRANK CRISP.  
G. W. CURRIE.  
F. GORE BROWNE.  
JAMES MARTIN.  
ALGERNON H. MILLS.

RICHD. D. MUIR.  
C. T. NEEDHAM.  
H. A. PAYNE.  
OWEN PHILIPPS.  
WILLIAM PLENDER.  
A. W. TAIT.  
J. A. TORRENS-JOHNSON.  
W. WALTER COOMBS,  
*Secretary.*

*July 15th, 1918.*

Mr. Torrens-Johnson dissociates himself from the recommendation that companies should be empowered to issue shares at a discount, and he has signed the foregoing report subject to that reservation.

#### NAMES OF THE WITNESSES WHO HAVE GIVEN EVIDENCE

LORD FARINGDON.	MR. W. WATKINS.
MR. CLAUSON, K.C.	MR. W. H. STENTIFORD.
MR. FREDK. WHINNEY.	MR. R. A. PINSENT.
LORD CUNLIFFE.	MR. J. W. BUDD.
MR. ERNEST COOPER.	SIR ALFRED A. BOOTH, BART.
THE RT. HON. F. HUTH JACKSON.	THE HON. MR. JUSTICE YOUNGER.
MR. A. W. FLUX.	SIR JOHN R. ELLERMAN, BART.
MR. HAROLD BROWN.	MR. S. E. CASH.
MR. H. E. BURGESS.	

#### RESERVATION BY MR. A. S. COMYNS CARR

It is with particular regret that I find myself unable to sign the Report without adding the following reservations. This is especially so in view of the fact that I have been unavoidably prevented from attending a considerable number of the meetings of the Committee. I have, however, carefully considered the evidence which has been given and the replies to the questionnaire issued by the Committee, and while in agreement with the greater part of the Report, and in particular with the recommendation that no steps should in general be taken to control the holding of shares by aliens, I consider it my duty to express my dissent from the following conclusions—

(1) Those relating to companies owning British shipping (paragraphs 21-29 inclusive).



The main question seems to me to be whether the experience of peace and war has shown that on balance this country has lost or gained more by permitting ships to be registered as British ships when they are owned by a company which has alien shareholders. It is to be noted that it is not usually a question of permitting a ship which would in any case be British to be under the control of aliens; the question is whether, if a number of persons, some or all of whom are aliens, own a ship, they should be permitted to register it as a British ship by forming themselves into a British company and establishing an office in the British Dominions. If they were not permitted to do so they would still own the ship, but register it as a foreign ship in some other country. It appears that a number of ships were registered here before the war by companies with alien shareholders (some even with enemy shareholders). They were (as the Committee were informed by a very distinguished representative of the shipping world) managed in this country; the profits earned by them were subject to our taxation; they were obliged to conform to the regulations of our Merchant Shipping Acts; they carried officers and men who were members of the Royal Naval Reserve; on the outbreak of war our Government was able to requisition the ships owing to their British registration and without regard to the nationality of the shareholders in the companies owning them.

It appears to me that all of these consequences have been highly advantageous to this country, and that none of them would have ensued if British registration had been refused to the ships in question. I have not been able to gather from the evidence on the subject (which shows considerable divergence of opinion) what are the disadvantages alleged on the other side. In any case in which the management has been suspect it has been open to the authorities during the war to supersede it by that of official controllers, if they did not wish to adopt the simpler and more efficacious remedy of requisitioning the ships. It is true that as the Merchant Shipping Acts now stand it was, until the passing of the British Ships (Transfer Restriction) Acts, 1915 to 1916, possible at any moment for the owners of a British ship to dispose of it and remove it from the register; it may be that it would be wise to alter this in future, and to require at least a substantial notice before the removal of a ship from the register; but in any case the position can be no worse than it would have been if the ship had never been on the register.

For these reasons I am unable to concur in the recommendation of my colleagues.

(2) Those relating to Key Industries (paragraphs 30-35 inclusive).

For similar reasons I am unable to concur in these recommendations. Again it appears to me that the important thing is to get the industries established in this country, and that the question of their ownership is of secondary consequence. In many cases, industries of the kind rather vaguely described as "Key industries" are the subject of patents which may be taken out by aliens; the policy of the Patents and Designs Act, 1907, is to compel such patentees to manufacture the patented article in this country; these recommendations seem to me to be in conflict with that policy, of which I approve. Further, if aliens are not permitted to own

such industries here, they will merely establish them elsewhere, and it by no means follows that any British subject will establish them here. In any case these recommendations would not prevent aliens from carrying on the same industries in this country as individuals or firms or by means of companies registered abroad. If restrictions are desired (which I deprecate) it seems to me that they would have to be imposed by a system of licensing similar to that adopted in the Non-Ferrous Metal Industry Act, 1918.

(3) Those relating to disclosure (paragraphs 15 and 16).

While agreeing that any system of enforcing disclosure of the nationality of shareholders must be cumbrous, and only partially effective, I would suggest that if any is adopted it should be confined to the element of control—i.e. it might be enacted that no voting power should attach to a share and no remedy be available in respect of a debenture, unless there had been lodged with the company (or filed with the Registrar) a reasonable time previously and confirmed at the time, declarations by the registered holder, and if he is a trustee, by the person or persons (or, in case any of them is a minor, his parent or guardian) claiming to be for the time being the ultimate beneficial owners, giving such particulars as may be required. As long as a declaration is furnished by some person who swears that he is the ultimate beneficial owner, intermediate trustees can (it seems to me) be ignored, and the risk of evasion is confined to the case where that person is prepared to commit deliberate perjury. This method would not interfere with bearer shares, nor with the free transfer of any securities, since the declaration would only be required as a condition of voting or otherwise exercising a right of control, and not as a condition of ownership. There may be certain advantages in knowing who are the real controlling parties in a company, apart altogether from the question of nationality.

(4) General Observations (paragraphs 64 and 65).

I cannot agree that the subjects dismissed in these two paragraphs were unworthy of the attention of the Committee. They are concerned mainly with the better prevention of various methods of company promotion and management which have involved the investing public in serious losses in the past. This appears to me to have a very special importance "having regard to circumstances arising out of the war and to the developments likely to arise on its conclusion." We have seen during the war a remarkably widespread diffusion of money, and a wonderful growth in the habit of investment, among classes of the population to whom both are a novelty. It is computed that no less than 13,000,000 people are directly interested in various forms of Government war securities. After the war it may be expected that a large number of people who never were investors before will be willing to entrust their savings to commercial companies, but will not be very well equipped to select those which are worthy of their confidence. Simultaneously there will be a large crop of new schemes appealing for public support, mostly *bond fide*, but offering unique opportunity to the fraudulent and over-sanguine. In my opinion it would be a disaster if by such means the money of the new class of investors were to be lost, and they were ultimately to be frightened away.

As the majority of the Committee have abstained from dealing with these questions, I can hardly go into them in detail, and will

only say that in my view the radical defect of our present system is that we allow companies to be registered, prospectuses to be issued, shares to be allotted, practically without check (except in mere formalities), and it is only after the harm is done and the money spent (often years after), that in a small proportion of the worst cases there follows official investigation and, in a still smaller proportion, punishment. In my view prevention is better than cure, and the right line of reform is to permit no prospectus or other appeal for funds to be issued in this country by any company, British or foreign, or by any person desiring to call attention to the merits of any company in order to dispose of its shares, unless a copy of the document is filed with the Registrar, and he is satisfied (not, of course, as to the truth of the statements contained in it) but that it does contain in a prominent position a plain answer to all questions on which the law requires disclosure, and unless there is also filed with him a statutory declaration by every director that he has investigated the statements and is satisfied of their truth. Further, no allotment should be permitted until the subscriptions are sufficient to provide, over and above any sums to be paid to vendors and promoters, a sum stated in the prospectus to constitute in the opinion of the directors adequate working capital. With these and other reforms (as to which valuable material exists in the information collected by the Committee) I am of opinion that the risk of the misfortunes which I have indicated might be greatly minimized.

A. S. COMYNS CARR.

July 15th, 1918.

*The Committee find it necessary to state the circumstances under which Mr. Comyns Carr has signed a minority report. He was present at two preliminary meetings on March 14 and April 23. At the next eleven meetings he was not present at all. These were the meetings at which the Committee heard the evidence and, upon its completion discussed all the materials before them, arrived at their conclusions and recommendations, and on June 11 adjourned for report. On June 25 and July 2 they settled the draft report—Mr. Carr was present for a short time on June 25. He did not attend the meeting on July 2.*

WRENBURY.  
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J. A. TORRENS-JOHNSON.

# INDEX

## A

	PAGE
ABRIDGED PROSPECTUS	
advertisement of . . . . .	224
application of Sec. 81 to . . . . .	224
Memorandum of Association need not be included in . . . . .	224

ACCOUNTS. See "Books and Accounts"; "Balance Sheet"; "Profit and Loss Accounts."

## ACCOUNTANT'S REPORT

averages in . . . . .	30
investigation and . . . . .	30
percentages in . . . . .	30
period to be covered by . . . . .	30
psychology and . . . . .	32
scope of . . . . .	30
stock in trade and . . . . .	31
tabulation of accounts and . . . . .	30, 34
turnover and . . . . .	30, 31, 34

## ADMINISTRATORS

Letters of Administration to be registered by . . . . .	249
Letters of Request should be furnished by . . . . .	250
liability for calls of . . . . .	250
proof of title of . . . . .	249
registration as members . . . . .	249
transmission of shares and position of . . . . .	249

## ADVERTISING AGENTS

arrangements with . . . . .	223
Dead Letter Office and . . . . .	223
prospectus usually advertised through medium of . . . . .	192
registers of shareholders kept by . . . . .	223

## AGENTS

advertising . . . . .	192, 223
application forms and signature by . . . . .	233
auditors as shareholders' . . . . .	152
brokerage payable to brokers and other recognized . . . . .	200
city runners as promoters' . . . . .	24
delegation of authority of . . . . .	131
directors as . . . . .	127
issuing houses as . . . . .	25
members of company not . . . . .	9
partners in firms as . . . . .	9
Post Office as applicant's . . . . .	236
promoter's . . . . .	24
publicity . . . . .	192, 223
secret profits must not be made by . . . . .	130

## ALIENS

PAGE

alteration of Articles and interests of . . . . .	120
companies may have members who are . . . . .	252
Lord Wrenbury's Committee and . . . . .	365
incorporation by . . . . .	375

## ALLOTMENT

applicant may waive notice of . . . . .	237
Board of Directors must make . . . . .	237
brokerage and . . . . .	200
court may order specific performance of . . . . .	237
filing of contracts constituting the title of allottees to . . . . .	244
financial books and . . . . .	246
form of . . . . .	238
irregular . . . . .	240
law of contract and . . . . .	231
letter of . . . . .	238
minimum subscription and . . . . .	239
nature of . . . . .	236
office procedure on . . . . .	245
over-subscription of issue and basis of . . . . .	241
Prospectus must give particulars of previous . . . . .	206
— must state amount payable upon . . . . .	206
return of . . . . .	245
shares allotted for consideration other than cash . . . . .	244
sheets used to record applications for and . . . . .	176
Stock Exchange rules as to . . . . .	245
under subscription of issue and . . . . .	243

## ALLOTMENT LETTER

communication of acceptance of application usually made by . . . . .	236
despatch of . . . . .	245
form of . . . . .	238
proof of posting of . . . . .	236
share certificate issued in exchange for . . . . .	179
stamp on . . . . .	238
Stock Exchange rule as to posting of . . . . .	245

## ANNUAL GENERAL MEETING

appointment of chairman at . . . . .	310
articles and notice of . . . . .	308
articles provide method of calling . . . . .	303
auditor, qua-auditor has no right to attend . . . . .	157
auditor's report must be read at . . . . .	304
cases in which notice need not be given of . . . . .	308
chairman's speech at . . . . .	304
check on directors afforded by . . . . .	150
company must hold once in every calendar year an . . . . .	303
Directors' Report and Accounts submitted at . . . . .	304
method of convening . . . . .	306
minutes of previous meeting read at . . . . .	303
notice of . . . . .	306

## ANNUAL GENERAL MEETING—(contd.)

	PAGE
proceedings at . . . . .	303
quorum must be present at . . . . .	309
re-election of directors and auditors at . . . . .	304
scope of business to be transacted at . . . . .	309
secretary usually reads notice calling . . . . .	304
Table "A" provisions as to . . . . .	353
time and place of holding . . . . .	307
voting at . . . . .	311

## ANNUAL LIST AND SUMMARY

auditors must audit statement in form of balance sheet	
contained in . . . . .	157
called-up capital and . . . . .	172
certificates to be filed by private companies with . . . . .	11
contents of . . . . .	171
date for completion of . . . . .	173
filing once in every calendar year of . . . . .	173
forfeited shares and . . . . .	172
list of members included in . . . . .	171
Lord Wrenbury's Committee and disclosures in . . . . .	380
mortgages and charges in total must be stated in . . . . .	173
particulars of persons who have ceased to be members	
included in . . . . .	171
private companies and . . . . .	10, 11
public companies and . . . . .	10, 11
share warrants and . . . . .	172
shares issued for cash must be distinguished from shares	
issued for other consideration in . . . . .	172
statement in form of balance sheet must be contained in . . . . .	10, 173
transfer of shares and . . . . .	172

## APPLICATION

conditional . . . . .	233
form of . . . . .	233
law of contract and . . . . .	231
method of dealing with . . . . .	234
nature of . . . . .	232
newspaper forms of . . . . .	225, 236
oral . . . . .	233
prospectus must state amount payable on . . . . .	206
revocation of . . . . .	232

## APPLICATION FORMS

agent's signature and authority to sign . . . . .	233
application and allotment sheets written up from . . . . .	235
bankers' statements should be checked with . . . . .	235
collection from bankers of . . . . .	231
filing of . . . . .	236
first Board Meeting and approval of . . . . .	149
method of dealing with . . . . .	234
newspaper . . . . .	224
signature of applicant on . . . . .	233
specimen of . . . . .	234

APPLICATION AND ALLOTMENT SHEETS OR BOOK		PAGE
allotment and method of writing up . . . . .		245
cash book reference folio recorded on . . . . .		176
different classes of shares, etc., and . . . . .		176
Register of Members written up from . . . . .	162,	176
ruling for . . . . .		178
shareholders' Cash Book and . . . . .		176
ARBITRATION		
Arbitration Act, 1889, applies to reconstruction . . . . .		115
Articles of Association may provide method of . . . . .		114
Companies Clauses (Consolidation) Act, 1845, applies to reconstruction . . . . .		114
dissentients under scheme of reconstruction and . . . . .		114
ARTICLES OF ASSOCIATION		
agreement between company and members as a body formed by . . . . .		117
alteration of . . . . .		120
bankruptcy provisions as to shares in . . . . .		251
commissions must be authorized by . . . . .		198
Companies Acts in relation to . . . . .		10
company and . . . . .	10, 11	117
company bound by Articles as though members had signed and sealed them . . . . .		117
contracts between company and persons not members not formed by . . . . .		117
disqualification of directors provided by . . . . .		139
dividends and . . . . .		42
effect of registration of . . . . .		121
evidence of contracts may be contained in . . . . .		117
form and contents of . . . . .		119
increase of capital must be provided for in . . . . .		101
indemnity clause in . . . . .		143
internal regulations of company governed by . . . . .		117
members on payment entitled to copy of . . . . .		90
memorandum over-rides . . . . .		117
must be divided into paragraphs . . . . .		119
— be printed . . . . .		119
— be stamped . . . . .		119
nature of . . . . .		117
non-members not entitled to copy of . . . . .		90
notice of Board Meetings and . . . . .		146
office of profit cannot be held by directors unless authorized by . . . . .		132
persons dealing with company not bound to see that it carries out regulations contained in . . . . .		118
private companies must have . . . . .		118
proceedings against directors and others for negligence may be nullified by . . . . .		143
public companies need not have . . . . .		118
reduction of capital and . . . . .		103
removal of directors provided by . . . . .		139
resignation of directors and . . . . .		139

ARTICLES OF ASSOCIATION (*contd.*)

	PAGE
share qualification of directors may be required by . . . . .	123, 136
signatories must sign . . . . .	116
special resolution necessary to alter . . . . .	120
Stock Exchange requirements as to . . . . .	338
Table "A" model set of . . . . .	118
transfer of shares and . . . . .	263
transmission clause of . . . . .	248

## ASSETS

Balance Sheet and arrangement of . . . . .	187
intangible . . . . .	86
specific reserves shown in balance sheet as deduction from . . . . .	188
valuation of . . . . .	35
winding-up and distribution of . . . . .	12
(See also "Fixed Assets," "Floating Assets," "Intangible Assets.")	

## ASSOCIATION CLAUSE

shares subscribed for by signatories must be stated in . . . . .	117
signatories' names and description set out in . . . . .	115

## ATTENDANCE BOOK

directors presence at Board Meetings should be recorded in . . . . .	751
---	-----

## AUDITORS

agency of . . . . .	152
Annual General Meeting and report of . . . . .	304
appointment of . . . . .	148, 152
Board of Trade may appoint . . . . .	152
check on directors afforded by report of . . . . .	150
debenture holders and inspection of reports of . . . . .	45
deterrent effect of powers of . . . . .	155
directors cannot be . . . . .	132
directors may appoint first . . . . .	153
Lord Wrenbury's Committee and . . . . .	380
offices of the company and . . . . .	151
preference shareholder and inspection of reports of . . . . .	45
prospectus must state names and address of . . . . .	210
re-election of retiring . . . . .	152
remuneration of . . . . .	152
rights and duties of . . . . .	154
secret reserves and duty of . . . . .	188
statement in form of Balance Sheets must be audited by . . . . .	157
statutory report must in part be certified by . . . . .	157, 302
standard of qualification of . . . . .	211
Table "A" provisions as to . . . . .	360

## AUTHORIZED OR NOMINAL CAPITAL

Balance Sheet and . . . . .	187
cancellation of . . . . .	109
capitalization of company and . . . . .	39
credit and low . . . . .	39



AUTHORIZED OR NOMINAL CAPITAL—(contd.)		PAGE
definition of . . . . .		54
division into different classes of shares of . . . . .		40
how fixed . . . . .		39
increase of . . . . .		106
Memorandum of Association and . . . . .		39
nominal value of shares comprising . . . . .		39
prospectus and statement of . . . . .		215
reduction of . . . . .		102
AVAILABLE PROFITS		
commercial idea of . . . . .		288
depreciation of assets and . . . . .		287
dividends payable out of . . . . .		287
legal idea of . . . . .		287
AVERAGES		
accountant's report and . . . . .		30
shareholders misled rather than helped by . . . . .		30
B		
BACKWARDATION		
definition of . . . . .		334
BALANCE RECEIPTS OR TICKET		
certification of transfers and issue of . . . . .		270
form of . . . . .		182
issue of . . . . .		181, 270
object of . . . . .		181
share certificates issued in exchange for . . . . .		179, 181
transferor usually entitled to . . . . .		181
BALANCE TICKET		
See "Balance Receipt."		
BALANCE SHEETS		
accountant, for investigation purposes, should tabulate . . . . .		32
Annual List and Summary must contain statement in . . . . .		4, 10
form of . . . . .		157, 173
auditors' report must be annexed or referred to in . . . . .		155
authorized or nominal capital and . . . . .		187
brokerage must be stated in . . . . .		199
calls in arrear, how shown on . . . . .		283
collateral security and . . . . .		78
commission on placing shares must be stated in . . . . .		199
company not bound under Act to prepare . . . . .		154
competitors and information given in . . . . .		184
condensation of published . . . . .		164
debtors and . . . . .		187
financial books should be organized to facilitate pre- paration of . . . . .		184
form of . . . . .		186

<b>BALANCE SHEETS—(contd.)</b>	<b>PAGE</b>
holding companies' . . . . .	188
order of assets and liabilities on . . . . .	186
reserves and . . . . .	188
shareholders and condensed . . . . .	185
— in holding companies and . . . . .	190
shares in subsidiary companies chief item in holding companies' . . . . .	190
standardized . . . . .	186
statement in form of . . . . . { 4, 10, 157	
statement in lieu of prospectus and . . . . . { 173, 185	
Table "A" requires preparation of . . . . .	228
two directors must sign . . . . .	154, 360
unclaimed dividends, how shown in . . . . .	155
underwriting commission must be stated in . . . . .	165
	199
<b>BANKERS</b>	
appointment of . . . . .	148
certificate of incorporation must be produced to . . . . .	148
dividends and instructions to . . . . .	291
lost dividend warrants and instructions to . . . . .	293
payment of dividends direct to . . . . .	166
public issue of capital and . . . . .	231
resolutions as to drawing, accepting, or endorsing Bills of Exchange and cheques must be notified to . . . . .	148
signatures of directors and secretary required by . . . . .	148
trading certificate will be required for inspection by . . . . .	148
<b>BANKRUPTCY ACTS, 1883 AND 1914</b>	
powers of trustee in bankruptcy under . . . . .	251
transmission of shares and . . . . .	251
<b>BANKRUPT MEMBERS</b>	
trustee in bankruptcy and powers to deal with shares of . . . . .	251
<b>BARGAIN BOOKS</b>	
records in . . . . .	332
<b>BEARER DEBENTURES</b>	
conditions usually endorsed on . . . . .	69-70
interest coupons attached to . . . . .	70
Lord Wrenbury's Committee and . . . . .	368
object of creating . . . . .	64
registration and . . . . .	64
<b>BEARER SHARES</b>	
See "Share Warrants."	
<b>BEARS</b>	
definition of . . . . .	334
<b>BILLS OF EXCHANGE</b>	
bankers require copy of resolution of directors as to drawing, accepting, and endorsing . . . . .	148
method of signing . . . . .	129
provisions of Act relating to . . . . .	130

<b>BILLS PAYABLE</b>	<b>PAGE</b>
Balance Sheet and . . . . .	187
<b>BILLS RECEIVABLE</b>	
Balance Sheet and . . . . .	187
<b>BLANK TRANSFERS</b>	
authority to fill in implied by deposit of . . . . .	274
mortgage of shares and deposit of . . . . .	274
notice to mortgagor before filling in . . . . .	274
Power of Attorney necessary, where transfer by deed, to fill in . . . . .	274
transfers by deed and . . . . .	274
<b>BOARD OF DIRECTORS</b>	
allotment must be made by duly constituted . . . . .	237
auditor may be appointed by . . . . .	152
Balance Sheet is signed by directors on behalf of whole directors must, unless Articles provide otherwise, act as a . . . . .	155
passing of transfers by . . . . .	145
vacancy on, how filled . . . . .	273
	124
<b>BOARD MEETINGS</b>	
Attendance Books should record presence of directors at . . . . .	175
auditor no right to attend . . . . .	157
directors, absence from . . . . .	147
— unless Articles otherwise provide, must act in . . . . .	145
form of acquiescence to resolutions passed at . . . . .	147
minutes of proceedings at . . . . .	146
notice of . . . . .	146
passing transfers at . . . . .	273
proceedings at first . . . . .	148
quorum necessary for conduct of business at . . . . .	146
remuneration of directors covers expense of attending . . . . .	133
secretary summons . . . . .	146
<b>BOARD OF TRADE</b>	
alteration of Articles and . . . . .	120
auditor may be appointed by . . . . .	152
inspectors appointed by . . . . .	285, 322
interest on capital and sanction of . . . . .	285
interests of aliens and . . . . .	120
investigations by . . . . .	285, 322
limited as part of company's name may be dispensed with under licence issued by . . . . .	91
name of company may be altered by special resolution and written consent of . . . . .	94
<b>BONUS SHARES</b>	
Articles must contain power to issue . . . . .	295
circumstances under which company can issue . . . . .	295
dividends payable by issue of . . . . .	296
fractions of shares and issue of . . . . .	296
records in financial books on issue of . . . . .	296

## BONUS SHARES—(contd.)

	PAGE
secretarial procedure on issue of . . . . .	296
taxation of . . . . .	296
undivided profits and issue of . . . . .	295

## BOOKS AND ACCOUNTS OF THE COMPANY

Annual List and Summary . . . . .	171
application and allotment sheets or book . . . . .	176
arrears of cumulative preference dividends and . . . . .	40
auditor has at all time right of access to . . . . .	154
Balance Sheet and arrears of cumulative dividends . . . . .	43
— Sheets . . . . .	184
— Ticket or Receipt Book . . . . .	181
capital reduction, records in . . . . .	105
civil liability of auditors . . . . .	157
conversion of shares into stock in . . . . .	50
— of shares into stock records in . . . . .	50
criminal liability of auditors . . . . .	157
Directors' Attendance Book . . . . .	175
Financial Books . . . . .	183
Minute Books . . . . .	169
notice of Transfers Lodged Book . . . . .	179
preliminary expenses, how dealt with in . . . . .	23
register of debenture holders . . . . .	69
— of directors and managers . . . . .	168
— of members and Share Ledger . . . . .	160
— of transfers . . . . .	174
registers of mortgages and charges . . . . .	72, 169
Seal Book . . . . .	175
Share Certificate Book . . . . .	177
security for loans and pledging . . . . .	60
Shareholders' Cash Book . . . . .	162, 177
— right to inspect . . . . .	{ 10, 45 69, 75
Table "A" provisions as to . . . . .	360
Transfer Fees Book . . . . .	182

## BORROWING POWERS OF COMPANY

companies which must have express . . . . .	59
effect of borrowing beyond express or implied . . . . .	59
exercise of . . . . .	59
limitation of . . . . .	58
Memorandum of Association and . . . . .	58
property capable of being pledged under . . . . .	60
remedies of lender where company has exceeded . . . . .	59
trading companies' implied power to borrow . . . . .	58

## BREACH OF TRUST

Court may relieve directors and others from liability for . . . . .	145
definition of . . . . .	143
directors' liability for . . . . .	141, 142
indemnity clause in Articles and . . . . .	143

<b>BREACH OF WARRANTY OF AUTHORITY</b>	<b>PAGE</b>
Directors may be liable for . . . . .	128
<b>BROKERAGE</b>	
allotment necessary to payment of . . . . .	200, 235
commission on placing shares and . . . . .	200
issue of shares at discount and . . . . .	200
list of . . . . .	235
nature of . . . . .	200
<b>BROKERAGE LIST</b>	
allotment and alteration of . . . . .	235
method of writing up . . . . .	235
ruling for . . . . .	235
<b>BULLS</b>	
definition of . . . . .	334
<b>C</b>	
<b>CALL BOOK</b>	
Register of Members written up from . . . . .	162
<b>CALLED-UP CAPITAL</b>	
Annual List and Summary must state particulars of . . . . .	172
definition of . . . . .	54
Directors may increase . . . . .	102
increase of . . . . .	102, 281
provisions of Act as to increase of capital do not apply to . . . . .	102
<b>CALL OPTIONS</b>	
definition of . . . . .	334
underwriting agreement may give . . . . .	193
<b>CALLS</b>	
advance payment of . . . . .	282
Annual List and Summary must state particulars of . . . . .	172
Articles of Association provide the rules for making . . . . .	119, 281
book-keeping entries with reference to . . . . .	283
date of passing resolution is date of . . . . .	282
Directors' power to make . . . . .	281
enforcement of . . . . .	284
estate of deceased member and liability for . . . . .	250
implied equality of shareholders as to . . . . .	282
instalments under terms of prospectus not termed . . . . .	281
interest on arrears of . . . . .	282
legal personal representatives and liability for . . . . .	250
paid-up capital increased by . . . . .	102
provisions of the Act as to . . . . .	282
rights of holders of different classes of shares and . . . . .	282
Statute of Limitations and . . . . .	282
Table "A" provisions as to . . . . .	348
transfer of shares and liability of parties for . . . . .	268

## CAPITAL

	PAGE
authorized . . . . .	39, 54
called-up . . . . .	54
Companies Acts and meaning of . . . . .	57
consolidation of share . . . . .	108
construction work and interest on . . . . .	284
dividends may not be paid out of . . . . .	284
factors to be considered in deciding form of . . . . .	52
increase of . . . . .	101
interest on calls paid in advance may be paid out of . . . . .	284
issued . . . . .	54
loanable . . . . .	56, 57
nominal . . . . .	39, 54
paid-up . . . . .	54
public issue of . . . . .	192
reduction of . . . . .	102
reorganization of share . . . . .	110
reserve . . . . .	55
share . . . . .	39
sub-division of share . . . . .	108
subscribed . . . . .	54
Table "A" provisions as to alteration of . . . . .	352
uncalled . . . . .	55
working . . . . .	38, 56

## CAPITAL CLAUSE OF MEMORANDUM

amount of nominal capital must be stated in . . . . .	100
Companies Act and alteration of . . . . .	100
Memorandum may provide for alteration of . . . . .	100
number and value of shares comprising nominal capital must be stated in . . . . .	100
variation of . . . . .	100

## CAPITAL DUTY

*See "Stamp Duties and Fees."*

## CAPITAL REDUCTION

*See "Reduction of Capital."*

## CAPITAL PROFITS

dividends may be paid out of realized . . . . .	284
---	-----

## CAPITALIZATION OF COMPANY

authorized capital and . . . . .	39
form of . . . . .	39
investors and . . . . .	53
loanable capital and . . . . .	53
scope of . . . . .	38
shares and . . . . .	39
working capital and . . . . .	38

CASH BOOK. *See "Shareholders' Cash Book."*

## CERTIFICATE OF IDENTITY

death of joint holders and . . . . .	250
--------------------------------------	-----

## CERTIFICATE OF INCORPORATION

	PAGE
bankers require to inspect . . . . .	148
conclusive evidence of . . . . .	85
date of incorporation is date of issue of . . . . .	85
does not entitle company to commence business . . . . .	85
first Board Meeting and inspection of . . . . .	148
form of . . . . .	85
issued by Registrar of Joint Stock Companies . . . . .	84
Lord Wrenbury's Committee and . . . . .	379

## CERTIFICATION OF TRANSFERS

balance receipt issued on . . . . .	270
estoppel and . . . . .	270
form of . . . . .	269
mistake in . . . . .	270
Provincial Stock Exchanges and . . . . .	269
registration of transfer not guaranteed by . . . . .	270
share certificate and . . . . .	270
transfer office routine on . . . . .	269
— receipts and . . . . .	271

## CERTIFICATES TO BE FILED BY PRIVATE LIMITED COMPANIES

Annual List and Summary and . . . . .	11
as to invitations to the public . . . . .	11
as to number of members . . . . .	11

## CHAIRMAN

adjournment of meeting by . . . . .	311
Annual General Meeting and speech of . . . . .	304
application of closure by . . . . .	311
appointment of directors' . . . . .	148
casting vote of . . . . .	311
duties and powers of . . . . .	310
meeting cannot act until chair taken by . . . . .	310
poll cannot be refused by . . . . .	312
time and place of poll fixed by . . . . .	313

## CHANGE OF ADDRESS

record in Register of Members of . . . . .	166
shareholders should notify company of permanent . . . . .	165

## CHEQUES

bankers require copy of resolution of directors as to . . . . .	
drawing and endorsing . . . . .	148
dividend warrants as . . . . .	292
method of signing . . . . .	129
provisions of Companies Act as to . . . . .	130
secretary countersigns . . . . .	151

## CHOSE IN ACTION

Judicature Act, 1873, and transfer of . . . . .	263
share in company is a . . . . .	263

CIRCULATING CAPITAL. See "Floating Assets."	PAGE
CITY RUNNERS	
definition of . . . . .	24
promoter's relation to . . . . .	24
touting by . . . . .	24
COLLATERAL SECURITY	
Balance Sheet and . . . . .	78
debentures issued by way of . . . . .	78
definition of . . . . .	78
records in financial books of . . . . .	78
COLONIAL COMPANIES. See "Foreign Companies."	
COLONIAL DEATH DUTY	
allowed as deduction from U.K. death duty . . . . .	162
COLONIAL REGISTER OF MEMBERS	
company must keep at registered office duplicate of . . . . .	161
Registrar of Companies and . . . . .	161
transfer of shares facilitated by keeping . . . . .	161
COMMENCEMENT OF BUSINESS	
business must be commenced within one year of	
incorporation . . . . .	89
contracts provisional only until company is entitled . . . . .	88
Directors' qualification shares and . . . . .	88
exercise of borrowing powers and . . . . .	60
filing of prospectus or statement in lieu of prospectus and . . . . .	88
incorporation of company and . . . . .	85
private companies and . . . . .	88
prospectus to be filed before . . . . .	88
public companies and restrictions on . . . . .	60, 88
restrictions on public companies and . . . . .	88
statement in lieu of prospectus to be filed before . . . . .	88
statutory declaration that provisions of Sec. 87 have	
been complied with . . . . .	88
Trading Certificate and . . . . .	89
COMMISSION	
brokerage . . . . .	200
broker's . . . . .	329
company may claim secret . . . . .	131
Corrupt Practices Act bars secret . . . . .	131
Directors and secret . . . . .	131
underwriting . . . . .	193, 209
placing shares and . . . . .	200
prospectus must state all payments by way of . . . . .	209
scale of broker's . . . . .	330
COMMISSION ON PLACING SHARES	
Balance Sheet must show amount of . . . . .	199
brokerage and . . . . .	200



COMMISSION ON PLACING SHARES—(contd.)		PAGE
nature of . . . . .		200
payment of . . . . .		200
provisions of Sec. 89 and payment of . . . . .		198
COMMITTEE OF STOCK EXCHANGE		
annual election of . . . . .		326
disputes of members referred to . . . . .		326
management of Stock Exchange in hands of . . . . .		326
official assignees appointed by . . . . .		326
COMPANIES ACTS		
how referred to . . . . .	I, 114	
limited companies governed by . . . . .	I	
meaning of "capital" in . . . . .		57
Memorandum and Articles subject to . . . . .		10
various . . . . .		I
COMPANIES CLAUSES CONSOLIDATION ACT, 1845		
reconstruction schemes and arbitration under . . . . .		114
transfer of shares under . . . . .		263
COMPANIES (FOREIGN INTERESTS) ACT, 1917		
interests of aliens and restriction on alteration of Articles by . . . . .		120
Lord Wrenbury's Committee and . . . . .		364
COMPANIES (OFFERS FOR SALE) ACT, 1924		
full text of . . . . .		203
not yet on Statute Book . . . . .		20
promoters and . . . . .		20
prospectus and . . . . .		202
COMPANIES (FOREIGN INTERESTS) ACT, 1917		
alteration of Articles limited by . . . . .		120
Board of Trade permission to alter Articles required under . . . . .		120
interests of aliens and . . . . .		120
COMPANIES (PARTICULARS AS TO DIRECTORS) ACT, 1917		
definition of "director" in . . . . .		168
Lord Wrenbury's Committee and . . . . .		364
publication of directors' names and nationality required by . . . . .		149
register of directors and managers and . . . . .		168
COMPROMISES AND ARRANGEMENTS		
creditors and . . . . .		112
Provisions of Sec. 120 of C. C. Act, 1908, as to . . . . .		112
sanction of the court required for . . . . .		112
— of the court to hold meetings for . . . . .	III, 112	
shareholders and . . . . .		112

# INDEX

401

CONTANGO RATE	PAGE
definition of . . . . .	334
CONTINGENT LIABILITIES	
arrears of cumulative preference dividends and . . . . .	41
Balance Sheet and . . . . .	188
uncalled liability on shares and . . . . .	55
CONTRACTS	
agents and . . . . .	91
Articles of Association do not form a contract with persons not members . . . . .	117
company must be entitled to commence business before it can make binding . . . . .	88
directors and company may enter into . . . . .	311
discharge of . . . . .	5
filing of . . . . .	244
law of . . . . .	6
material . . . . .	210
members below minimum, effect on . . . . .	3
Memorandum and Articles and . . . . .	6
methods of entering into . . . . .	5
name of company must include word " limited " in all . . . . .	91
personal liability of directors and agents on . . . . .	129
preliminary . . . . .	23
prospectus and material . . . . .	210
seal of company and . . . . .	5
simple or parole . . . . .	5
specialty . . . . .	5
Trading Certificate and . . . . .	89
variation of . . . . .	5
CONTROLLING INTEREST	
holding companies and . . . . .	189
CONVERSION OF SHARES INTO STOCK	
entries in Financial Books on . . . . .	50
mode of . . . . .	49
notice to Registrar of Register of Members and . . . . .	50, 161
power of . . . . .	49
Table " A " provisions as to . . . . .	351
CO-PARTNERSHIP SHARES	
definition of . . . . .	48
misconduct of employees and . . . . .	49
rights given to holders of . . . . .	48
transfer of . . . . .	49
CORPORATIONS PROFIT TAX	
See " Taxation of Limited Companies."	
CORRUPT PRACTICES ACT	
secret commissions barred by . . . . .	131

## CUM DIVIDEND

PAGE

sale of shares . . . . .	269
transferee entitled to dividend if shares bought . . . . .	269

## CUMULATIVE PREFERENCE SHARES

arrears of . . . . .	40
— of dividend on . . . . .	41, 106
how dealt with in accounts . . . . .	41
lapse of right to cumulation dividends on . . . . .	41
Memorandum and Articles and . . . . .	40
shares deemed to be . . . . .	41
surrender of claim to arrears of dividend on . . . . .	106
winding-up and arrears of . . . . .	43

## CREDITORS

alterations in Memorandum and . . . . .	98
arrangements with . . . . .	112
Balance Sheet and arrangements of . . . . .	187
compromises with . . . . .	112
Court will, in capital reduction schemes, consider inter- ests of . . . . .	105
insolvent debtors attempts to obtain priority over . . . . .	8
preferential . . . . .	12, 59
right to petition in winding-up . . . . .	14
secured . . . . .	12

## D

## DEBENTURES

bearer . . . . .	64, 70
classification of . . . . .	64
collateral security and . . . . .	78
conditions of issue of . . . . .	69
— usually endorsed on . . . . .	69
confusion of debenture stock with . . . . .	61
creation of other debentures ranking <i>pari passu</i> with existing . . . . .	61
date of creation of . . . . .	73
debenture stock and . . . . .	61, 63
equities and . . . . .	69
fixed mortgage . . . . .	67
floating mortgage . . . . .	65
form of . . . . .	63
fraudulent conveyances and . . . . .	8
insolvent debtors and . . . . .	8
irredeemable . . . . .	62
issue of shares at discount by exchange for . . . . .	77
issued by insolvent companies . . . . .	80
— under seal . . . . .	61
joint holders and . . . . .	69
Lord Wrenbury's Committee and . . . . .	368
Memorandum of Articles may restrict the issue of misuse of . . . . .	58 8

## DEBENTURES—(contd.)—

	PAGE
naked . . . . .	64
not confined to companies . . . . .	61
notes and . . . . .	80
objects of issuing . . . . .	62
one-man companies and . . . . .	80
promoter and . . . . .	8
prospectus and issue of . . . . .	77, 78
price of issue of . . . . .	77
redemption of . . . . .	79
repayment of principal moneys secured by . . . . .	69
— of sums secured by mortgage . . . . .	62
rights of holders of . . . . .	76
right of holders to receive reports and accounts . . . . .	45
series of . . . . .	61
single . . . . .	61
specific performance of contract to take or issue . . . . .	77
stamp duty on . . . . .	78
transfer of . . . . .	69
trust deeds and . . . . .	62
trustees for holders of . . . . .	63
underwriting issue of . . . . .	193
winding-up and issue of . . . . .	77

## DEBENTURE HOLDERS

accounts and reports and . . . . .	77
inspection of registers by . . . . .	75
rights of . . . . .	76
Trust Deed and mortgage . . . . .	70

## DEBENTURE STOCK

bearer . . . . .	64
charge on property sometimes excluded in issue of . . . . .	63
confusion of debentures with . . . . .	61, 63
definition of . . . . .	63
form of . . . . .	63
registered . . . . .	64
transferable in fractional amounts . . . . .	63
trustees for holders of . . . . .	63

## DEBTORS

Balance Sheet should distinguish between cash and trade . . . . .	187
---	-----

## DEFERRED OR FOUNDERS' SHARES

control of company by holders of . . . . .	48
definition of . . . . .	47
Memorandum and Articles and . . . . .	48
prospectus and . . . . .	48, 204
statement in lieu of prospectus and . . . . .	228
vendors and promoters and . . . . .	48

## DEFUNCT COMPANIES

PAGE

removal from register of . . . . .	17
unlimited liability of members of . . . . .	18

## DELEGATION OF AUTHORITY

Directors and . . . . .	131
-------------------------	-----

## DIRECTORS

acts of disqualified . . . . .	147
additional remuneration of . . . . .	133
agency and . . . . .	127
Annual General Meeting and Report and Accounts of . . . . .	304
Annual List and Summary must contain particulars of . . . . .	172
appointment of . . . . .	122, 123
appointment of committees of . . . . .	132
— of managing . . . . .	132
apportionment of remuneration of . . . . .	133
apportionment of valuation of assets by . . . . .	36
Articles of Association may provide that members only can be appointed . . . . .	122
attendance book of . . . . .	175
auditors cannot be appointed as . . . . .	132
— have no duty to advise . . . . .	156
bankers will require specimen signatures of . . . . .	148
bankrupts may be appointed . . . . .	139
Board Meetings and . . . . .	145, 146
breach of warranty of authority and liability of . . . . .	59
calls on shares and powers of . . . . .	281
certification of Statutory Report by . . . . .	303
checks on . . . . .	150
commercial training should be possessed by . . . . .	124
Companies (Particulars as to Directors) Act and definition of . . . . .	169
company may recover secret profits made by . . . . .	131
— need not have . . . . .	122
conflict of interests of . . . . .	131
consent to act must be filed by . . . . .	11
contracts and personal liability of . . . . .	129
delegation of authority of . . . . .	131
disqualification of . . . . .	138
dividends paid out of capital and liability of . . . . .	142, 289
errors of judgment on part of . . . . .	130
executive affected by bad administration by . . . . .	127
forfeiture of shares and procedure of . . . . .	276
foreign companies and definition of . . . . .	5
"Guinea Pig" . . . . .	124
interim dividends declared by . . . . .	285
irregular allotments and liability of . . . . .	241
knowledge required by . . . . .	125
law of agency governs relationship between company and its . . . . .	128
legal standard of efficiency of . . . . .	127, 130
liability for negligence of . . . . .	130, 141 144

## DIRECTORS—(contd.)

	PAGE
Lord Wrenbury's Committee and disclosure of nationality of	367
machinery of business and	261
membership of company not essential to appointment of	
persons as	122
minutes of proceedings at meetings of	146, 171
misfeasance and	142, 143
mistake to appoint large number of	122
non-active	124
non-disclosure in prospectus and liability of	213
objects clause in Memorandum and powers of	96
office of profit held by	132
penalties imposed by the Act on	144
penalty on acting disqualified	139
persons named in Articles of Association as	123
policy of company should be directed, guided, and	
governed by	125
power to increase capital may be vested in	101
private companies need not file consent to Act	11
promoter and	25
promoter usually influences appointment of	122
prospectus must contain disclosure of interests of	131, 211
— and liability for misrepresentation by	218
prospectus must state remuneration of	205
— names, addresses, and occupations of	205
provisions of Table "A" as to disqualification of	139
publication of names of	149
qualification shares	131, 136
ratification of acts of	128
re-election of retiring	140
register of managers and	168
relief from liability for negligence given to	145
removal of	138
remuneration of	132
reports of	45
resignation of	138
retirement in rotation of	140
right to be indemnified against losses and expenses	130
secret profits must not be made by	130
share market receives too much attention from certain	126
share qualification of	123
signing of prospectus by all	222
signatories may appoint first	116
— to Memorandum and Articles as	116
Table "A" provides that one share must be held by each	
of the	122
Table "A" provisions as to	356, 357
taxation of fees and remuneration of	7
transfer of shares and powers of	262
trustees and	127
<i>ultra vires</i> acts of	96
unlimited liability of	99
vacancy on board of	124
winding-up and powers of	16

DIRECTORS' FEES AND REMUNERATION. <i>See</i> "Remuneration of Directors."	PAGE
DIRECTORS' REPORT	
debenture holders and inspection of . . . .	45
preference shareholders and inspection of . . . .	45
DISCLAIMER	
trustee in bankruptcy and right of . . . .	251
DISCOUNT ON SHARES	
brokerage and . . . . .	200
commission on placing shares and . . . . .	200
debentures and . . . . .	77
Lord Wrenbury's Committee and . . . . .	374
underwriting commission and . . . . .	198
DISCOUNT ON DEBENTURES	
Balance Sheet must show . . . . .	77
discount on shares and . . . . .	77
issue may be made with . . . . .	77
DISSENTIENT SHAREHOLDERS	
arbitrator may be appointed by . . . . .	115
executors of deceased members may act as . . . .	114
liquidator must be given option by . . . . .	114
loss of rights of . . . . .	{ 114, 115 116
reference to arbitration by . . . . .	114
shareholders who vote in favour of scheme of recon- struction cannot be . . . . .	114
DIVIDENDS	
arrears of cumulative preference . . . . .	{ 41, 43 106
Articles of Association fix method of declaring and paying . . . . .	119, 285
available profits for purposes of . . . . .	287, 289
bonus shares and payment of . . . . .	284, 297
— issued by way of . . . . .	297
calculation of . . . . .	42
capital may not be used for payment of . . . . .	284
commercial idea of profits available for . . . . .	288
cumulative preference . . . . .	40
deferred . . . . .	48
definition of . . . . .	283
depreciation and profits available for . . . . .	287
difference between interest on loanable capital and directors' liability for payment out of capital of . . .	52 142, 289
final . . . . .	289
fixing preference shares . . . . .	51
forfeiture of unclaimed . . . . .	286
"Free of Tax" . . . . .	6
general consideration of preference . . . . .	42

## DIVIDENDS—(contd.)

	PAGE
interest on capital sunk in construction work and . . . . .	284
interim . . . . .	285, 289
legal attitude towards payment of . . . . .	287
non-cumulative preference . . . . .	42
notice in lieu of distringas and payment of . . . . .	275
office procedure for payment of . . . . .	290
ordinary . . . . .	47
profits and . . . . .	33, 52
rate of tax to be deducted on payment of . . . . .	290
realized capital profits may be distributed in dividend . . . . .	284
reduction of capital schemes and preference . . . . .	107
ruling of list for . . . . .	291
sale of shares " cum " . . . . .	269
— " ex " . . . . .	269
Statute of Limitations and . . . . .	286
Table " A " and . . . . .	42
— provisions as to . . . . .	359
tax deducted from . . . . .	6
transfer of shares and right of parties to . . . . .	268
winding-up and arrears of cumulative preference . . . . .	43

## DIVIDEND COUPONS

delivery of share warrants bad without . . . . .	259
share warrants must have attached . . . . .	257, 259

## DIVIDEND LIST

bonus shares and . . . . .	296
dividend warrants prepared from . . . . .	292
ruling for cash . . . . .	291

## DIVIDEND WARRANTS

dividend list and preparation of . . . . .	292
Finance Act, 1924, and . . . . .	6
form of . . . . .	294
gross dividend payable must be shown on . . . . .	293
lost . . . . .	293
nature of . . . . .	292
net dividend payable must be shown on . . . . .	293
secretary countersigns . . . . .	151
Sec. 33 of Finance Act, 1924, and . . . . .	293
shareholder retains top part of . . . . .	293
tax deducted must be shown on . . . . .	273
voucher for Income Tax and . . . . .	292

## DOCUMENTS

definition given in Sec. 285 of the Act of . . . . .	95
Seal Book contains record of sealed . . . . .	175
service on company of . . . . .	95

## DOMICILE OF COMPANY

Act of Parliament necessary to alter . . . . .	95
alteration of . . . . .	95
must be stated in Memorandum . . . . .	90
procedure where Irish Free State is . . . . .	95
Registered Office distinguished from . . . . .	95



## DOUBLE OPTIONS

definition of . . . . .	PAGE 335
-------------------------	-------------

## E

## ESTATE DUTY

death of member registered in Colonial Register and payment of British . . . . .	162
---	-----

## ESTOPPEL

certification of transfers and . . . . .	270
forged transfers and doctrine of . . . . .	267
membership may be constituted by . . . . .	247
share certificate and operation of . . . . .	256

## EXECUTORS

letters of request should be furnished by . . . . .	250
liability for calls and . . . . .	250
probate to be registered by . . . . .	249
proof of title of . . . . .	249
registration as members of . . . . .	249
transmission of shares and the position of . . . . .	249

## EXPERT REPORTS

accountant's . . . . .	29
averages in . . . . .	30
estimates of profits in . . . . .	29
information contained in . . . . .	30, 35
methods of preparing Accountant's Report . . . . .	29
object of . . . . .	29
percentages in . . . . .	30
period covered by . . . . .	30
promoter and untrue statements in . . . . .	36
promoters' and directors' liability for statements . . . . .	28
prospectus and . . . . .	216
valuer's . . . . .	35

## EXPERTS

accountants as . . . . .	28
definition and status of . . . . .	28
liability of promoter for untrue statements in reports of . . . . .	28
promoter and incompetent . . . . .	28
prospectus and reports of . . . . .	216
qualifications of . . . . .	29
valuers as . . . . .	35

## EXTRAORDINARY GENERAL MEETING

convening of . . . . .	304
definition of . . . . .	104
notice of . . . . .	306
quorum must be present at . . . . .	305
Sec. 66 of the Act and . . . . .	309
shareholders may requisition . . . . .	305

## EXTRAORDINARY RESOLUTION

	PAGE
Articles and . . . . .	319
business requiring an . . . . .	316
definition of . . . . .	315
filing of . . . . .	317, 319
increase of capital under Table "A" requires . . . . .	101
notice of meeting and . . . . .	316
removal of director under Table "A" requires . . . . .	140
winding-up and . . . . .	15

## F

## FALSIFICATION OF ACCOUNTS

auditors criminally liable for . . . . .	150
directors criminally liable for . . . . .	144

## FINANCE ACT, 1924

Corporation Profits Tax removed by . . . . .	7
dividend warrants and . . . . .	6, 293
form of dividend warrant required by . . . . .	294
Sec. 33 of . . . . .	293
Sec. 34 of . . . . .	7
standardization of dividend warrants by . . . . .	293

## FINANCE ACT, 1922

limited companies may be liable to Super-tax under . . . . .	7
provisions of Sec. 21 of . . . . .	7

## FINANCIAL BOOKS

allotment records in . . . . .	246
bonus share records in . . . . .	296
dividend records in . . . . .	292
professional accountant should advise as to . . . . .	183

## FIRMS

See "Partnerships."

## FIXED ASSETS

available profits and depreciation of . . . . .	287
Balance Sheet and arrangement of . . . . .	187
debentures and charge on . . . . .	68
definition of . . . . .	287

## FIXED MORTGAGE DEBENTURES

charge usually restricted to fixed assets . . . . .	68
conditions usually endorsed on . . . . .	69
difference between floating and . . . . .	67
form of . . . . .	69
interest on . . . . .	62
issue of . . . . .	77
repayment of sums secured by . . . . .	62
rights of holders of . . . . .	76
Trust Deeds and . . . . .	62, 70
trustees and property charged in . . . . .	68

## FLOATING ASSETS

PAGE

available profits and depreciation of . . . . .	287
Balance Sheet and arrangement of . . . . .	187
debentures and charge on . . . . .	68
definition of . . . . .	287

## FLOATING MORTGAGE DEBENTURES

charge does not become effective until default . . . . .	65
— usually restricted to floating assets . . . . .	68
company may deal with property charged in . . . . .	65
conditions usually endorsed on . . . . .	69
definition of . . . . .	87
difference between fixed and . . . . .	67
fixed mortgage debentures may be created in priority to form of . . . . .	66
goods in hands of sheriff and holder of . . . . .	69
judgment creditors and holders of . . . . .	67
landlord and holders of . . . . .	67
may give charge on assets and undertaking . . . . .	65
preferential creditors and holders of . . . . .	67
restriction clause in . . . . .	66
winding-up, effect on holders of . . . . .	67

## FOREIGN CAPITAL

Lord Wrenbury's Committee and . . . . .	362
---	-----

## FOREIGN COMPANIES

companies domiciled in Irish Free State come within provisions of Act as to . . . . .	95
documents to be filed by . . . . .	4
limited liability of . . . . .	4
particulars of directors of . . . . .	4
publicity of country of incorporation . . . . .	4
publicity of name of . . . . .	4
service of process on . . . . .	4
statement in form of balance sheet and . . . . .	4
Stock Exchange requirements as to . . . . .	345

## FORFEITURE OF SHARES

Annual List and Summary must give number of shares forfeited . . . . .	172
annulment of . . . . .	278
Articles of Association provide method of . . . . .	119
book-keeping records on . . . . .	278
cancellation of . . . . .	278
enforcement of lien on shares by . . . . .	281
liability of holders after . . . . .	277
liquidation and . . . . .	277
notice of . . . . .	276
preliminaries to . . . . .	276
provisions of Articles must be strictly adhered to on . . . . .	276
right of directors to proceed with . . . . .	275
sale by company of forfeited shares . . . . .	277, 278
sanction of Court not required for . . . . .	105

FORFEITURE OF SHARES—( <i>contd.</i> )	PAGE
share capital account and re-issue of . . . . .	279
shareholders' failure to notify changes may involve the .	165
— rights on wrong . . . . .	277
Table "A" and . . . . .	276
— — provisions as to . . . . .	350

# FORGED TRANSFERS

Court may order rectification of register in case of .	165
doctrine of estoppel and position of the company as to	267
Forged Transfer Acts and . . . . .	267
notice of transfers lodged to transferor and . . . .	267
rights of transferee under . . . . .	267
transferee cannot be placed on register in respect of .	267

# FORGED TRANSFER ACTS, 1891 AND 1892

funds of company may be used to indemnify persons	
under . . . . .	267
position of company under . . . . .	267

# FORM OF APPLICATION

*See "Application Forms."*

# FORMATION OF LIMITED COMPANIES

Companies Acts . . . . .	2
effect on credit of business by . . . . .	8
expenses of . . . . .	23
fraudulent conveyance and . . . . .	8
insolvent debtors and . . . . .	8
promoter prime mover in . . . . .	19
promoter's profit on . . . . .	25
Royal Charter . . . . .	2
special Acts . . . . .	2

# FOUNDERS' SHARES

*See "Deferred Shares."*

# FRAUDULENT CONVEYANCES

credit and . . . . .	8
debenture and . . . . .	8
effect of . . . . .	8
insolvent debtors and . . . . .	8

# G

GENERAL MEETINGS. *See "Annual General Meeting,"*  
*"Extraordinary General Meeting," and "Statutory*  
*Meeting."*

# GENERAL PROXY

definition of . . . . .	314
stamp duty on . . . . .	314
<i>Also see "Proxies."</i>	

GOODWILL	PAGE
Balance Sheet and statement of . . . . .	187
nature of . . . . .	208
profits prior to incorporation and writing down . . . . .	86
Promoter's profit and . . . . .	25
prospectus must show amount payable for . . . . .	208
purchase consideration should distinguish payment in respect of . . . . .	208

GUINEA PIGS	
definition of . . . . .	124
object of appointment of . . . . .	124

## H

HOLDING COMPANIES	
Balance Sheets of . . . . .	188, 190
controlling interest of . . . . .	189
definition of . . . . .	188
object of . . . . .	189
public or private companies may be . . . . .	189
shareholders' position in . . . . .	190
subsidiary companies may also be . . . . .	189

## I

ILLEGAL ASSOCIATIONS	
banking partnership . . . . .	2
contracts of . . . . .	3
trade unions . . . . .	3
trading partnership . . . . .	2

INCOME TAX. *See* "Taxation of Limited Companies."

## INCORPORATION

business must be commenced within a year of . . . . .	89
certificate of . . . . .	85
commencement of business and . . . . .	85
date of . . . . .	85
definition of . . . . .	85
effect of . . . . .	85
name of company entered on register on . . . . .	84
profits earned prior to . . . . .	85
taxation adjustment between vendor and purchaser on . . . . .	86

## INCREASE OF CAPITAL

Articles of Association must provide for . . . . .	101
Capital Duty not payable on if made simultaneously with reduction . . . . .	101, 102
— — payable on . . . . .	101
Directors may have power to . . . . .	101
Inland Revenue concession as to capital duty on . . . . .	101
registrar to be given notice of any . . . . .	101
special resolution may be necessary to . . . . .	101
Table "A" provisions as to . . . . .	352

INDEMNITY CLAUSE	PAGE
City Equitable case and . . . . .	143
directors and officers may be relieved from liability for negligence by . . . . .	143
investors ascertain from Articles scope of . . . . .	143
proceedings under Sec. 215 may be defeated by . . . . .	143
INFANTS	
membership of companies and . . . . .	253
misfeasance to allot shares knowingly to . . . . .	254
repudiation of contract to take shares by . . . . .	254
voidable contracts and . . . . .	235
IRREGULAR ALLOTMENT	
liability of Directors for . . . . .	241
period in which action is to be taken on . . . . .	241
rights of allottees on . . . . .	241
INSOLVENT DEBTORS	
formation of limited companies by . . . . .	8
fraudulent conveyance by . . . . .	8
INSPECTION OF REGISTER OF MEMBERS	
Court may compel . . . . .	168
liquidation puts an end to right of . . . . .	168
penalty for failure to allow . . . . .	168
persons not shareholders may, on payment, inspect Register of Members . . . . .	167
shareholders may, free of charge, inspect Register of Members . . . . .	167
INSPECTORS	
appointment of Board of Trade . . . . .	322
duties of . . . . .	322 <i>et seq.</i>
shareholders may appoint. . . . .	323
INSTALMENTS	
advance payments of . . . . .	282
book-keeping entries with reference to . . . . .	283
calls on shares to be distinguished from prospectus . . . . .	281
interest on . . . . .	282
INSURANCE COMPANIES	
standardized accounts of . . . . .	186
INTANGIBLE ASSETS	
goodwill as one of the . . . . .	208
profits prior to incorporation may be used for writing down . . . . .	86
INTEREST COUPONS	
bearer debentures and . . . . .	70
<i>See also</i> "Dividend Coupons."	

INTEREST ON LOANABLE CAPITAL PAGE

coupons attached to bearer debentures and . . . . .	70
considerations to be taken into account when fixing . . . . .	51
difference between dividends and . . . . .	52
profits and . . . . .	52

## INTEREST ON UNPRODUCTIVE CAPITAL

Board of Trade may sanction payment of . . . . .	285
conditions attached to payment of . . . . .	284
construction work and payment of . . . . .	284

## INVESTIGATIONS

audited accounts simplify work on . . . . .	30
Board of Trade . . . . .	285, 322
method of accountants' . . . . .	30
period to be covered by . . . . .	30
scope of accountants' . . . . .	30
shareholders' . . . . .	323
— right to . . . . .	321
tabulation of accounts necessary in . . . . .	30

## INVESTMENTS

Balance Sheet should distinguish cash from . . . . .	187
--	-----

## INVESTORS

capitalization of company and . . . . .	53
indemnity clause of Articles and . . . . .	143
loanable capital and . . . . .	53
purchases and sales by . . . . .	329
stockbrokers and . . . . .	331

ISSUED CAPITAL. *See* "Subscribed Capital."

## ISSUING HOUSES

capital found by . . . . .	24
promoter in relation to . . . . .	24

## J

## JOINT HOLDERS

certificate of death of . . . . .	250
— of identity to be furnished by . . . . .	250
execution of transfers by . . . . .	264
qualification shares held by . . . . .	138
Table "A" provisions as to . . . . .	355
transmission of shares on death of . . . . .	250

## JUDICATURE ACT, 1873

transfer of shares and . . . . .	263
----------------------------------	-----

## L

## LEGAL PERSONAL REPRESENTATIVES

*See* "Executors," "Administrators," "Trustee in Bankruptcy," and "Liquidator."

LEGAL PROCEEDINGS	PAGE
change of company's name and . . . . .	95
service of documents . . . . .	95
LETTERS OF ADMINISTRATION	
administrators must register . . . . .	249
fee payable on registration of . . . . .	166
Register of Members and registration of . . . . .	249
transmission of shares and production of . . . . .	249
LETTER OF ALLOTMENT. <i>See</i> "Allotment Letter."	
LETTER OF INDEMNITY	
form of . . . . .	257
loss of share certificates and . . . . .	256
stamp duty on . . . . .	257
LETTERS OF REGRET	
despatch of . . . . .	245
form of . . . . .	243
over-subscription and despatch of . . . . .	242
LETTER OF REQUEST	
registration of representative and . . . . .	249
transmission of shares and registration of representatives by . . . . .	249
LIEN ON SHARES	
Articles of Association and . . . . .	280
enforcement of . . . . .	281
extent of . . . . .	280
forfeiture of shares and enforcement of . . . . .	281
mortgages of shares and company's . . . . .	281
Stock Exchange rules as to . . . . .	280
Table "A" provisions as to . . . . .	348
LIMITED COMPANIES. <i>See</i> "Private Limited Companies" and "Public Limited Companies."	
LIMITED LIABILITY	
by guarantee . . . . .	2
by shares . . . . .	2
difference between firms and limited companies as to . . . . .	9
Directors and . . . . .	9
foreign companies and . . . . .	4
loss of . . . . .	2, 18
nature of . . . . .	3
note issuing bank and . . . . .	2
partly by guarantee and partly by shares . . . . .	2
LIMITED PARTNERSHIPS	
general partners and . . . . .	10
liability of partners of . . . . .	9
LIQUIDATION	
<i>See</i> "Winding-up."	



## LIQUIDATORS

PAGE

dissentient shareholders under reconstruction schemes, and . . . . .	114
distribution of assets by . . . . .	12
object of appointment of . . . . .	12
reconstruction and option of . . . . .	114
rectification of register cannot be made by . . . . .	165
transfer of shares by . . . . .	252

## LIST OF CONTRIBUTORIES

members placed on " A " . . . . .	99
qualification shares and . . . . .	137
transferors and " B " . . . . .	99, 268

## LOANABLE CAPITAL

capitalization of company and . . . . .	53
definition of . . . . .	56
holders of loanable capital not members . . . . .	56
never to be referred to as capital without qualification . . . . .	57
right of holders to attend meetings and vote . . . . .	56
voting powers of holders of . . . . .	56

## LUNATIC MEMBERS

Order of Court appointing committee to deal with shares of . . . . .	252
shares of . . . . .	252

## M

## MANAGING DIRECTORS

appointment of . . . . .	132
duties of . . . . .	132

## MARRIAGE

company should be supplied with certificate of . . . . .	166
fee for registration of . . . . .	166
notification by lady shareholders must be given to com- pany of . . . . .	166

## MATERIAL CONTRACTS

definition of . . . . .	210
oral contracts may be . . . . .	210
prospectus must contain particulars of . . . . .	210
statutory meeting and variation of terms of . . . . .	210

## MEETINGS

Annual General . . . . .	303
appointment of chairman at . . . . .	310
board . . . . .	145
classification of shareholders' . . . . .	285
conduct of . . . . .	309
convening of . . . . .	306
demand for poll at . . . . .	312

## MEETINGS—(contd.)

	PAGE
Extraordinary General . . . . .	304
Minutes of Board . . . . .	146, 171
— of shareholders' . . . . .	171
notice of . . . . .	306
quorum at . . . . .	309
— necessary for Board . . . . .	146
resolutions at . . . . .	315
sanction of Court required under Secs. 45 and 120 of Act to hold . . . . .	III, 112
share warrant holders and notice of . . . . .	258
special . . . . .	305
voting at . . . . .	311

MEMBERS. See "Shareholders," "Bankrupt members," "Lunatic members," and "Membership."

## MEMBERSHIP

agreement to take shares necessary to . . . . .	247
allotment of shares does not constitute . . . . .	237, 248
constitution of . . . . .	237, 247
defunct companies and liability of . . . . .	18
entry on Register of Members essential to . . . . .	247
estoppel and . . . . .	247, 248
evidence of . . . . .	254
forfeiture of shares and cessation of . . . . .	277
liability may become unlimited . . . . .	3
— of members . . . . .	23, 99
members not agents . . . . .	9
minimum number of members . . . . .	3
persons may be estopped from denying . . . . .	247
Register of Members and . . . . .	238
share certificates as evidence of . . . . .	255
subscribers to Memorandum and . . . . .	247
transfer of shares and . . . . .	248
transmission clause of Articles and . . . . .	248
— of shares and . . . . .	248
who may be included in . . . . .	252

## MEMORANDUM OF ASSOCIATION

abridged prospectus and . . . . .	224
alteration not readily effected of . . . . .	97
alteration of capital clause may be provided for in . . . . .	100
alterations in capital must be incorporated in . . . . .	110
Association clause of . . . . .	116
Auditors' statutory powers cannot be interfered with by . . . . .	154
capital clause of . . . . .	100
Companies Acts and . . . . .	10
company and . . . . .	10
domicile clause . . . . .	95
— of company must be stated in . . . . .	90
effect of registration of . . . . .	121
issue of debentures may be restricted by . . . . .	58
limited liability clause . . . . .	98

## MEMORANDUM OF ASSOCIATION—(contd.)

	PAGE
limited liability of members must be stated in . . . . .	90
limits powers and activities of company . . . . .	90
Lord Wrenbury's Committee and the . . . . .	378
membership and subscribers to . . . . .	247
members' right to copy of . . . . .	90
name clause . . . . .	90
— of company must be stated in . . . . .	90
nature of . . . . .	90
nominal capital and number of shares into which it is divided must be stated in . . . . .	100
non-members have no right to copy of . . . . .	90
objects clause . . . . .	95, 97
— of company must be stated in . . . . .	90
requirement of the Act as to clauses in the . . . . .	90
right to create different classes of shares where power not contained in . . . . .	100
rights of shareholders may be varied as provided in the . . . . .	101
seven persons must sign public company's . . . . .	116
share capital of company must be stated in . . . . .	90
signatories must sign . . . . .	116
two persons must sign private company's . . . . .	116
subscribers to . . . . .	91
<i>ultra vires</i> acts and . . . . .	96
unlimited liability of directors and alteration of . . . . .	99

## MINIMUM NUMBER OF MEMBERS

effect of number of members falling below . . . . .	3, 99
private limited company . . . . .	3, 10
public limited company . . . . .	3, 10

## MINIMUM SUBSCRIPTION

commencement of business and . . . . .	89
definition of . . . . .	239
directors' liability as to . . . . .	240
irregular allotment and . . . . .	240
private limited companies and . . . . .	11, 89
prospectus must state amount of . . . . .	206
public limited companies and . . . . .	89, 207, 237
shares issued for other than cash consideration not to be included in . . . . .	240
waiver of provisions as to . . . . .	240

## MINUTE BOOKS

company must keep directors' and shareholders' . . . . .	169
proceedings of meetings recorded in . . . . .	169
sealing of documents and . . . . .	175
secretary responsible for writing-up . . . . .	171

## MINUTES

alterations of minutes should be affected by further minutes . . . . .	171
Board Meeting proceedings must be recorded in . . . . .	146
directors initial alterations in . . . . .	171
<i>prima facie</i> evidence of proceedings . . . . .	147, 171
secretary is responsible for recording . . . . .	146, 171

MISFEASANCE

PAGE

allotment of shares to infants and . . . . .	254
definition of . . . . .	143
indemnity clause in Articles and . . . . .	143
proceedings in liquidation for . . . . .	142

MISREPRESENTATION

action for deceit and . . . . .	218
defences open to person defending an action for . . . . .	221
liability of estate of deceased person responsible for . . . . .	220
loss of rights of person injured by . . . . .	220
prospectus and . . . . .	218
remedies of persons induced to take shares or debentures by . . . . .	218
Sec. 84 and proceedings against directors for . . . . .	219
signatories' rights against company for promoters' . . . . .	116

MORTGAGE DEBENTURES

See "Fixed Mortgage Debentures" and "Floating  
Mortgage Debentures."

MORTGAGE OF SHARES

absolute . . . . .	274
advance in respect of . . . . .	273
blank transfer deposited by way of equitable . . . . .	274
equitable . . . . .	274
fraud and . . . . .	275
legal . . . . .	274
lien of shares held by company and rights of mortgagees on a . . . . .	281
Lord Wrenbury's Committee and . . . . .	368
notice in lieu of distringas and . . . . .	275

MORTGAGES AND CHARGES

Annual List and Summary must state particulars of . . . . .	173
register of . . . . .	169

N

NAKED DEBENTURES

investor and . . . . .	65
mere acknowledgment of debt . . . . .	65
notes and . . . . .	81
rights of holders of . . . . .	76
unsecured creditors rank equally with holders of . . . . .	65

NAME OF COMPANY

agents and omission of word "limited" in . . . . .	91, 94
alteration of name by Board of Trade . . . . .	94
— — — by Registrar . . . . .	94
cheques and . . . . .	94
choice of . . . . .	91
companies engaged in the promotion of art, religion, science, etc., and . . . . .	91

## NAME OF COMPANY—(contd.)

PAGE

existing companies and . . . . .	92
legal proceedings and change in . . . . .	95
legislation and misleading . . . . .	92
licence of Board of Trade to omit word " limited " from	91
" limited " as last word in . . . . .	90
Lord Wrenbury's Committee and . . . . .	373
memorandum must state . . . . .	90
misleading . . . . .	92
must be painted or affixed to every office and place of	
business . . . . .	94
Parliamentary questions dealing with . . . . .	92
partnerships and individuals and . . . . .	92
penalties for omission to comply with rules as to . . . . .	94
promoters and misleading . . . . .	93
restrictions on use of certain words in . . . . .	91
sanction of Home Secretary necessary to use words	
" Royal " or " Imperial " in . . . . .	91
Special Resolution required for alteration of . . . . .	94

## NEGLIGENCE

auditors are liable for . . . . .	157
Court may relieve directors and others from liability for	142, 145
Directors are liable for . . . . .	130, 142
errors of judgment not . . . . .	142
estate of deceased director and liability for . . . . .	144
indemnity clause in Articles and . . . . .	143
liquidation and proceedings for . . . . .	142
promoter is liable for . . . . .	27
relief from liability for . . . . .	142
remedy by action for . . . . .	142

## NOMINAL CAPITAL. See " Authorized Capital."

## NOMINEES

shares placed in the names of . . . . .	244, 266
underwriters may name sub-underwriters as . . . . .	195

## NON-CUMULATIVE PREFERENCE SHARES

arrears of dividends on . . . . .	42
clear expression necessary that shares shall be . . . . .	42

## NOTES

definition of . . . . .	81
naked debentures and . . . . .	81
private companies and issue of . . . . .	82
promissory notes and . . . . .	81

## NOTICE IN LIEU OF DISTRINGAS

affidavit stating mortgagee's interest must be lodged	
with Court . . . . .	275
company bound to take notice of . . . . .	275
dividends may be covered by . . . . .	275
mortgagee gives . . . . .	275
rules of Supreme Court as to . . . . .	275
time given to mortgagor to take steps on lodgment of . . . . .	275

## O

## PAGE

## OBJECTS CLAUSE

activities of company restricted by . . . . .	96
alteration of . . . . .	97
careful wording is necessary of . . . . .	96
company may do anything fairly incidental to main object in . . . . .	96
creditors and alterations in . . . . .	98
debenture holders and alterations in . . . . .	98
Directors' powers and . . . . .	96
general power "to do all or any other things" ineffec- tive in . . . . .	96
Memorandum of Association and . . . . .	95
must not contain any illegal power . . . . .	96
powers of company fixed in . . . . .	96
sanction of Court necessary to alterations in . . . . .	98
scope of . . . . .	99
special resolution and consent of Court necessary to alter <i>ultra vires</i> acts and . . . . .	97
winding-up and company's main object . . . . .	96

## OFFERS FOR SALE

Companies (Offers for Sale) Act, 1924, and . . . . .	202
provisions of Sec. 81 frequently avoided by . . . . .	202
public issue of capital by means of . . . . .	202
public protection needed in case of . . . . .	202
Stock Exchange and . . . . .	202

## OFFICE OF PROFIT

Articles may authorize directors to hold . . . . .	132
--	-----

## OFFICERS OF THE COMPANY

auditors may be . . . . .	151
persons who are not . . . . .	158
secretary as officer . . . . .	150

## OFFICIAL ASSIGNEES OF STOCK EXCHANGE

Act of Bankruptcy and . . . . .	326
appointment of . . . . .	326
defaulting members dealt with by . . . . .	326
security given by . . . . .	326

## OFFICIAL QUOTATION

application for . . . . .	337
prospectus and Stock Exchange . . . . .	214

## OPTIONS

call . . . . .	334
definitions of . . . . .	334, 335
double . . . . .	335
put . . . . .	335

## ORDINARY RESOLUTION

business dealt with by . . . . .	315
definition of . . . . .	315
winding-up and . . . . .	15

## ORDINARY SHARES

PAGE

classes of . . . . .	47
conversion of preference shares into . . . . .	47
definition of . . . . .	44
distinctions between " A " and " B " . . . . .	47
method of valuing . . . . .	215
rights of holders of . . . . .	47

## OVER-RIDING COMMISSIONS

nature of . . . . .	194
underwriters and . . . . .	194
underwriting commission compared with . . . . .	194

## OVER-SUBSCRIPTION

basis of allotment on . . . . .	241
closing of list on . . . . .	241
country applications and . . . . .	241
letters of regret and . . . . .	242
stags and . . . . .	242

## P

## PAID-UP CAPITAL

accumulated profits and return of . . . . .	105
definition of . . . . .	54

PARENT COMPANIES. *See* " Holding Companies."

## PARTNERSHIPS

banking . . . . .	2
differences between limited companies and . . . . .	9
distinct entity of Scottish . . . . .	9
effect of Partnership Act, 1890, on . . . . .	10
firms not distinct entities . . . . .	9
illegal associations . . . . .	2
limited companies and . . . . .	9
——— may be in . . . . .	10
members as agents of . . . . .	9
membership of companies, inclusion of . . . . .	253
partners' right to transfer their shares in . . . . .	10
trading . . . . .	2
transfers not good delivery if signed in firm name of . . . . .	253
unlimited liability of members of . . . . .	9

## PERMISSION TO DEAL ON STOCK EXCHANGE

rules as to application for . . . . .	335
---------------------------------------	-----

## PERCENTAGES

accountant's report and . . . . .	30
investors mislead rather than helped by . . . . .	30

## PETITION FOR WINDING-UP

Courts in which to present . . . . .	16
who may . . . . .	14

## PLEDGING PROPERTY OF COMPANY

	PAGE
books of the company which may be pledged . . . . .	60
fixed assets . . . . .	68
floating assets . . . . .	68
power to pledge property . . . . .	58
property capable of being pledged . . . . .	60
reserve capital may not be pledged . . . . .	55, 60
uncalled capital may be pledged if company has express power . . . . .	60

## POLL

Articles govern the method of demanding a . . . . .	312
calculation of majority on a . . . . .	313
chairman cannot refuse properly demanded . . . . .	312
common law right to demand a . . . . .	312
invalidation of . . . . .	313
method of voting on a . . . . .	313
place of . . . . .	313
resolutions must be put separately on a . . . . .	313
scrutineers may be appointed to vouch for correctness of statutory right to demand a . . . . .	313
Table "A" provisions as to . . . . .	355
time for demanding . . . . .	312

## POOL OF SHARES

underwriting and . . . . .	193
----------------------------	-----

## POWER OF ATTORNEY

blank transfers and . . . . .	274
fee for registration of . . . . .	166
joint holders of shares and . . . . .	265
registration of . . . . .	264
revocation, by death of principal, of . . . . .	264
stamp on . . . . .	264

## PREFERENCE SHARES

accounts and reports and holders of . . . . .	45
arrears of cumulative dividends on . . . . .	41, 43, 106
control of company by holders of . . . . .	46
conversion into ordinary shares of . . . . .	44
cumulative . . . . .	40
— participating . . . . .	44
— — convertible . . . . .	44
definition of . . . . .	40
dividends on . . . . .	40
fixing dividends on . . . . .	51
method of valuing . . . . .	215
nature of preference attaching to . . . . .	40
necessity for clearly defining rights attaching to . . . . .	44
non-cumulative . . . . .	42
participating . . . . .	44
priority as to return of capital on . . . . .	43
rights of holders of . . . . .	40, 42, 44
shares deemed to be cumulative . . . . .	41
voting powers of holders of . . . . .	46



## PREFERENTIAL CREDITORS

PAGE

floating mortgage debentures and . . . . .	67
landlord and . . . . .	13
naked debentures and . . . . .	65
secured creditors and . . . . .	12
under Sec. 209 . . . . .	12

## PRELIMINARY OR PROMOTION EXPENSES

how dealt with in the books of the company . . . . .	23
items included in . . . . .	24
liability of promoter in respect of . . . . .	23, 24
premium on shares may be utilized for writing down . . . . .	24
prospectus and . . . . .	24

## PRIVATE LIMITED COMPANY

Annual List and Summary and . . . . .	11
borrowing powers of . . . . .	58
certificates to be filed, together with Annual List and Summary, by . . . . .	10
commencement of business by . . . . .	85
contracts of . . . . .	5
debenture holders and inspection of reports and accounts of . . . . .	45
definition . . . . .	1
distinct entity of . . . . .	1
domicile of . . . . .	90, 95
filing of director's consent to act . . . . .	11
firms and . . . . .	9
issue of notes by . . . . .	80
liability to Super Tax of . . . . .	7
Lord Wrenbury's Committee and . . . . .	382
loss of privileges and exemptions of . . . . .	11
maximum number of members . . . . .	3
members' liability . . . . .	2
members not agents of . . . . .	9
minimum number of members . . . . .	3, 10
minimum subscription and . . . . .	6
must have Articles of Association . . . . .	118
name of . . . . .	91
partnership and . . . . .	10
preference shareholders and inspection of reports and accounts of . . . . .	45
privileges of . . . . .	10
public companies and . . . . .	10
registered office of . . . . .	95
statement in form of Balance Sheet and . . . . .	10
statutory meeting must be held by . . . . .	10, 299
Statutory Report need not be submitted by . . . . .	{ 10, 231
taxation of . . . . .	300
Super-tax on undivided profits of . . . . .	6
	8

## PROBATE

	PAGE
executors must register . . . . .	249
fee for registration of . . . . .	166
Register of Members and registration of . . . . .	249
transmission of shares and production of . . . . .	249

## PROFIT AND LOSS ACCOUNTS

accountant, for investigation purposes, should tabulate	30
condensation of published . . . . .	184
financial books should be organized to facilitate preparation of . . . . .	184
Lord Wrenbury's Committee and disclosure of . . . . .	380
statement in form of Balance Sheet need not show balance of . . . . .	174, 185

## PROFITS

accumulated profits and reduction of paid-up capital . . . . .	105
agents must not make secret . . . . .	130
commercial idea of available . . . . .	288
Directors must not make secret . . . . .	137
dividends can only be paid out of . . . . .	281
house transactions and . . . . .	34
incorporation and adjustment of . . . . .	85
interest on loanable capital may vary with . . . . .	62
legal attitude towards available . . . . .	287
preference dividends payable out of . . . . .	43
prospectus and adjustments of . . . . .	33
reduction of paid-up capital by return of accumulated . . . . .	105
taxation of . . . . .	6
withholding distribution of . . . . .	286

## PROFITS PRIOR TO INCORPORATION

adjustment of . . . . .	85
distribution of . . . . .	86
goodwill written down out of . . . . .	86
interest chargeable against . . . . .	86
taxation and . . . . .	86

## PROMISSORY NOTES

Bills of Exchange Act, 1882, and . . . . .	81
definition of . . . . .	81
method of signing . . . . .	129
provisions of Act relating to . . . . .	130

## PROMOTER

agents of . . . . .	24
appointment of directors and officers of the company usually influenced by . . . . .	122
capital arrangements and . . . . .	192
city runners and . . . . .	24
Companies (Offers for Sale) Act, 1924 (Bill), and . . . . .	20, 210
definition of . . . . .	19
deposit payable by . . . . .	36
dividend payments as test of honesty of . . . . .	21

## PROMOTER—(contd.)

	PAGE
duties of . . . . .	20
experts and . . . . .	28
fiduciary position of . . . . .	22, 23
hidden identity of . . . . .	19
issuing houses and . . . . .	24
liability of . . . . .	27
may be individual, firm, or syndicate . . . . .	19
misrepresentation and liability of . . . . .	116, 218
non-disclosure in prospectus and liability of . . . . .	213
not to be condemned without trial . . . . .	20
option money payable by . . . . .	36
preliminary contracts and . . . . .	23
profit of . . . . .	25
promotion expenses and . . . . .	23
prospectus must state interest in promotion of . . . . .	209
relation to company of . . . . .	22
secret profits and . . . . .	22
signatories to Memorandum may have right of action against . . . . .	116
unscrupulous . . . . .	21
work usually carried out by . . . . .	21

## PROMOTER'S PROFIT

form of . . . . .	25
nature of . . . . .	25
taxation of . . . . .	26

## PROMOTION EXPENSES

See " Preliminary Expenses."

## PROSPECTUS

abridged . . . . .	223
adjustment of profits for purposes of . . . . .	33
advertising and despatching . . . . .	223
advertising agents and advertisement of . . . . .	192
auditor's name and address must be stated in . . . . .	210
commencement of business and filing of . . . . .	88
commissions payable or paid within two years preceding issue of . . . . .	209
Companies (Offers for Sale) Act, 1924, and . . . . .	202
companies to which Sec. 81 applies . . . . .	203
contents of . . . . .	202
dating, signing, and filing of . . . . .	222
definition of . . . . .	201
differences between statement in lieu of prospectus and Directors' interests and the . . . . .	228
Directors' interests in company must be disclosed in . . . . .	131
Directors or proposed directors must sign . . . . .	222
drafting of . . . . .	202
effect of non-compliance with Sec. 81 as to contents of . . . . .	212
first Board Meeting and directors' approval of . . . . .	149
foreign companies and definition of . . . . .	5
goodwill must be separately stated in . . . . .	208

PROSPECTUS—(contd.)	PAGE
hints on reading the . . . . .	226
information other than statutory information usually given in . . . . .	214
issue of . . . . .	222
issue of debentures by means of . . . . .	77, 78
material contracts must be stated in . . . . .	210
misrepresentation in . . . . .	218
nature of . . . . .	201
newspaper criticisms of . . . . .	225
offer and acceptance and publication of . . . . .	232
offers for sale and . . . . .	202, 203
over-emphasis of virtues of business in . . . . .	217
particulars of vendors must be given in . . . . .	207
preliminary expenses and . . . . .	24, 209
profits adjustments for . . . . .	33
promoter's interest in promotion must be stated in . . . . .	209
provisions of Sec. 81 to be complied with as to . . . . .	203
purchase consideration must be stated in . . . . .	208
scope of information given in . . . . .	202
share certificates and . . . . .	177
share qualification must be stated in . . . . .	138, 204
shares issued otherwise than for cash must be stated in . . . . .	207
solicitor and counsel should draft . . . . .	202
turnover for purposes of . . . . .	31, 34
underwriters and draft . . . . .	195
underwriting commission must be stated in . . . . .	198
voting rights of different classes of shareholders and . . . . .	211
waiver of information to be contained in . . . . .	212

## PROXIES

Articles fix form of . . . . .	314
common law does not give right to vote by . . . . .	314
form of . . . . .	356
general proxy . . . . .	314
kinds of . . . . .	314
lodgment of . . . . .	314
revocation of . . . . .	315
special proxy . . . . .	314
stamp duty on . . . . .	314
Table "A" provisions as to . . . . .	355

## PUBLIC ISSUE OF CAPITAL

advertisement of prospectus . . . . .	192
allotment on over-subscription of . . . . .	241
company's alternatives in regard to . . . . .	192
newspaper advertising and . . . . .	223
offers for sale and . . . . .	202
prospectus usual mode of making . . . . .	201
reconstruction and . . . . .	201
underwriter's liability on under-subscription of . . . . .	193
underwriting of . . . . .	193

PUBLICITY AGENTS. *See* "Advertising Agents."

## PUBLIC LIMITED COMPANY

	PAGE
Annual List and Summary must be filed by . . . . .	173
Articles of Association optional in case of . . . . .	118
borrowing powers of . . . . .	58
commencement of business by . . . . .	89
contracts of . . . . .	5
debenture holders and inspection of reports and accounts of . . . . .	45
definition . . . . .	1
differences between firms and . . . . .	9
— — — private and . . . . .	10
distinct entity of . . . . .	1
domicile of . . . . .	90, 95
firms and . . . . .	9
liability to super-tax . . . . .	7
members' liability . . . . .	2
members not agents of . . . . .	9
minimum number of members of . . . . .	3, 10
name of . . . . .	90, 91
partnerships and . . . . .	9
preference shareholders and inspection of reports and accounts of . . . . .	45
Registered Office of . . . . .	95
statement in form of Balance Sheet and . . . . .	173, 190
— in lieu of prospectus must be filed by . . . . .	88, 227
statutory meeting must be held by . . . . .	299
— report must be submitted by . . . . .	300
super-tax on undivided profits of . . . . .	8
taxation of . . . . .	6

## PURCHASE CONSIDERATION

allocation of . . . . .	36
goodwill must be shown in prospectus separately from total . . . . .	208
prospectus must contain particulars of . . . . .	208
taxation and . . . . .	36
valuation of assets and . . . . .	36

## PUT OPTIONS

definition of . . . . .	335
-------------------------	-----

## Q

## QUALIFICATION SHARES

Articles of Association and . . . . .	{ 136, 137
blank transfer of . . . . .	138
Companies Acts do not require directors to hold . . . . .	137
Directors must not accept gift of . . . . .	136
— must be legal owners of . . . . .	131, 137
— need not be beneficial owners of . . . . .	138
— who act, deemed to have agreed to take . . . . .	138
filing of contract to take . . . . .	137
	11

## QUALIFICATION SHARES—(contd.)

	PAGE
joint holding of . . . . .	138
liability of directors to pay for . . . . .	137
misfeasance and . . . . .	137
promoter must not be given blank transfer in respect of . . . . .	137
prospectus must state particulars of . . . . .	138, 204
share warrants cannot be counted as part of . . . . .	138, 259
Table "A" silent as to . . . . .	136

## QUORUM

Board Meetings and . . . . .	146
General Meetings and . . . . .	309
must be present throughout proceedings . . . . .	309
Table "A" provides that directors may fix . . . . .	146

## R

## RAILWAY COMPANIES

Balance Sheet prepared on double account system by . . . . .	186
formed under special Acts of Parliament . . . . .	2
standardized accounts and statistical returns of . . . . .	186

## RECONSTRUCTION

arbitration and . . . . .	114
death of arbitrator appointed under scheme of . . . . .	115
executor as dissentient to . . . . .	114
involves sale of undertaking for shares . . . . .	113
liquidator and . . . . .	114
loss of rights of dissentients to scheme of . . . . .	115
objects of . . . . .	113
procedure under Sec. 192 not necessary where power contained in Memorandum for . . . . .	114
public issue of capital and . . . . .	201
reorganization of capital not to be referred to as . . . . .	113
rights of dissentient shareholders in . . . . .	114

## RECTIFICATION OF REGISTER OF MEMBERS

cases in which Court has exercised power for . . . . .	165
Court alone can order the . . . . .	164
liquidation does not prevent . . . . .	165
membership and . . . . .	248
oral transfers of share and . . . . .	264
secretary may rectify mere clerical errors . . . . .	165

## REDUCTION OF CAPITAL

advertisement of Order of Court as to . . . . .	105
"And Reduced," Court fixes period for which these words are to be used on . . . . .	104
— — — may be dispensed with by Order of Court if rights of third parties do not intervene . . . . .	104
— — — must be used as part of company's name on application to Court for sanction of scheme of . . . . .	103
Articles of Association may make provision for . . . . .	103

REDUCTION OF CAPITAL—(*contd.*)

	PAGE
Court does not necessarily require to be shown that capital has been lost in respect of . . . . .	104
— may order publication of reasons for . . . . .	105
creditors' rights considered by Court in . . . . .	103, 104
— — may be affected by . . . . .	103
dividends and schemes for . . . . .	107
Financial Books and record of . . . . .	105
Lord Wrenbury's Committee and . . . . .	377
preference shares and . . . . .	106, 107
preservation of rights of different classes of shareholders on . . . . .	106
procedure on . . . . .	102
provisions of Act as to . . . . .	102
reduction of ordinary share capital merely book-keeping entry . . . . .	106
reserve capital or liability and . . . . .	55
rights of shareholders and effect of . . . . .	106
sanction of Court required to scheme for . . . . .	103
— — not required in certain cases . . . . .	105
schemes should be submitted to principal shareholders of classes affected . . . . .	108
share capital account and . . . . .	105
— certificates and . . . . .	105
shareholders' rights considered by Court in . . . . .	103
two special resolutions required where Articles of Association do not provide for . . . . .	103

## REGISTERED DEBENTURES

conditions usually endorsed on . . . . .	69
form of . . . . .	69
register of holders of . . . . .	69
transfer of . . . . .	64

## REGISTERED OFFICE

changes in address of . . . . .	95
documents and notices may be served at . . . . .	95
domicile and . . . . .	95
duplicate of Colonial Register must be kept at . . . . .	161
memorandum need not state address of . . . . .	95
must be within limit of domicile . . . . .	95
Register of Members must be kept at . . . . .	167
Registrar must be notified of changes in . . . . .	95
registration of situation of . . . . .	95, 148

## REGISTER OF DEBENTURE HOLDERS

closing of . . . . .	69
conditions as to keeping . . . . .	69
debenture holders may require copies of . . . . .	75
inspection of . . . . .	69, 75
register of mortgages and charges must not be confused with . . . . .	72
shareholders may require copies of . . . . .	75

REGISTER OF DIRECTORS AND MANAGERS	PAGE
companies must keep . . . . .	168
Companies (Particulars as to Directors) Act and . . . . .	168
filing with Registrar of Companies copy of . . . . .	168
names, addresses, and occupation of directors recorded in . . . . .	168
penalty for failure to make entries in . . . . .	168
Registrar of Companies must be notified of alterations or changes in . . . . .	168
ruling of . . . . .	170
REGISTER OF MEMBERS AND SHARE LEDGER	
advertisement in press on closing . . . . .	166
books from which to write up . . . . .	162
charge for copies of . . . . .	167
closing of . . . . .	166
Colonial Register deemed to be part of . . . . .	162
contents of . . . . .	160
conversion of preference into ordinary shares, entries in . . . . .	45, 50
conversion of shares into stock, entries in . . . . .	160
copies may be obtained of . . . . .	167
forged transfers and right of true owner of shares to be placed on the . . . . .	267
inspection of . . . . .	167
issue of share warrants, entries in . . . . .	160, 258
liquidation ends right to inspect and require copies of . . . . .	168
maximum period for closing . . . . .	166
membership and entry on . . . . .	247
penalty for failure to make entries in . . . . .	160
<i>prima facie</i> evidence of entries in . . . . .	160
rectification of . . . . .	164, 248
Registered Office prescribed place for keeping . . . . .	167
registration of changes in . . . . .	165
registration of fictitious names . . . . .	254
— of legal personal representative in . . . . .	249
ruling for . . . . .	163
secretary may rectify mere clerical errors in . . . . .	165
Share Ledger usually bound with . . . . .	162
Statutory Meeting and inspection of . . . . .	299
surrender of share warrant necessary before entry of holder on . . . . .	258
transferee under forged transfer cannot be entered on . . . . .	267
transfer office and . . . . .	160, 167
transmission of shares and records in . . . . .	249
trusts not to be entered on . . . . .	162
REGISTER OF MORTGAGES AND CHARGES	
company must keep . . . . .	72, 169
effect of failure to make entries in . . . . .	73
form of ruling for . . . . .	170
inspection of . . . . .	75
particulars to be contained in . . . . .	72
penalty on directors and officers for omission to make entries in . . . . .	72, 169
Registrar of Companies keeps . . . . .	72, 169
register of debenture holders must not be confused with . . . . .	72



## REGISTER OF TRANSFERS

PAGE

bound book as . . . . .	174
companies should keep . . . . .	174
guard book as . . . . .	174
Register of Members posted from . . . . .	174

## REGISTRAR OF COMPANY

certification of transfers and work of . . . . .	269
professional accountant often called upon to act as . . . . .	149
registration of transfers and work of . . . . .	272
remuneration of outside . . . . .	182
stamp duty on transfers and liability of . . . . .	272
transfer fees payable to . . . . .	182

## REGISTRAR OF JOINT STOCK COMPANIES

certificate of incorporation issued by . . . . .	84
commencement of business and filing of statutory declaration with . . . . .	88
contracts to be filed with . . . . .	244
name of company may in certain cases be altered with consent of . . . . .	94
prospectus cannot be issued to public until copy has been filed with . . . . .	223
Registered Office, notices of changes in must be given to return of allotments to be filed with . . . . .	95
situation of office at which Colonial Register is kept must be notified to . . . . .	245
statement in prospectus as to filing copy with . . . . .	161
Statutory Report must be filed with . . . . .	214
trading certificate issued by . . . . .	303
	89

## REGISTRATION OF COMPANY

avoidance of liability by . . . . .	9, 40
credit of business and . . . . .	9, 39
directors and . . . . .	83, 84
effect of filing Memorandum and Articles on . . . . .	121
list of persons consenting to become directors to be filed before . . . . .	83
Lord Wrenbury's Committee and . . . . .	373
matters incidental to . . . . .	83
Memorandum and Articles to be filed before . . . . .	83, 121
solicitor and . . . . .	83
stamp duties and fees payable on . . . . .	84
statutory declaration that Companies Acts have been complied with, to be filed before . . . . .	84

## REGISTRATION OF MORTGAGES AND CHARGES

avoidance of . . . . .	74
effect of non-registration . . . . .	73
memorandum of satisfaction and . . . . .	73
mortgages and charges requiring . . . . .	73
object of . . . . .	74
particulars to be registered . . . . .	72
penalties for non-registration . . . . .	72, 74

## REGISTRATION OF TRANSFERS

	PAGE
notification to transferor on . . . . .	271
share certificates and . . . . .	177
stamp duty and registrar's liability on . . . . .	272
transferee usually presents transfer for . . . . .	271
transferor may present transfer for . . . . .	271
transfer office procedure on . . . . .	271

## REMUNERATION OF AUDITOR

Board of Trade may fix . . . . .	152
Directors may in certain cases fix . . . . .	152
how fixed . . . . .	152

## REMUNERATION OF DIRECTORS

additional . . . . .	133
apportionment of . . . . .	133
Articles of Association of resolution or shareholders fixes " free of tax " . . . . .	132, 133
Lord Wrenbury's Committee and taxation of . . . . .	134
Prospectus must state . . . . .	381
right to . . . . .	205
taxation of . . . . .	132
travelling expenses, unless otherwise agreed, are covered by . . . . .	134
waiver of . . . . .	133
winding-up and . . . . .	134
	133

## REORGANIZATION OF CAPITAL

Memorandum need not give power for . . . . .	111
Order of Court necessary to make effective resolution for privileges of special classes of shares safeguarded on . . . . .	111
provisions of Secs. 45 and 120 compared as to . . . . .	111
reconstruction of company and . . . . .	111
resolution required under Sec. 45 for . . . . .	113
	111

REPORT OF LORD WRENBURY'S COMPANY LAW  
AMENDMENT COMMITTEE

alien shareholders and . . . . .	365
assessments on shareholders and . . . . .	376
audit and Auditor's Report and . . . . .	380
bearer shares and . . . . .	374
disclosure and . . . . .	367
— of Profit and Loss Account and . . . . .	380
distinguishing numbers of shares and . . . . .	381
foreign capital and . . . . .	362
free of Income Tax payments to directors and . . . . .	381
Fresh Issues Committee and . . . . .	374
incorporation by aliens and . . . . .	373
issue of shares at a discount and . . . . .	374
key industry companies and . . . . .	371
limited companies generally and . . . . .	367

REPORT OF LORD WRENBURY'S COMPANY LAW AMENDMENT COMMITTEE—(contd.)		PAGE
Memorandum of Association and	.	378
minority	.	383
name of company and	.	373
payment of dividends out of capital and	.	377
private companies and	.	382
reduction of capital and	.	377
registrar's certificate and	.	379
shipping companies and	.	370
RESERVE CAPITAL		
alteration of	.	55
creation of charge on	.	55
form of resolution for creating	.	55
modes of creation of	.	55
mortgage of	.	55
reduction of capital and	.	55
RESERVE LIABILITY. See "Reserve Capital."		
RESOLUTIONS		
classes of	.	315
extraordinary	.	{ 15, 101
other	.	{ 140, 315
	.	{ 111, 320
ordinary	.	{ 15, 140
	.	{ 315
	.	{ 14, 15, 94
	.	{ 97, 99
	.	{ 101, 103
special	.	{ 105, 109
	.	{ 120, 140
	.	{ 317
Statutory Meeting and	.	299
RETURN OF ALLOTMENTS		
filing of	.	245
object of filing	.	246
particulars to be contained in	.	246
penalty for non-filing of	.	246
RIGGING A MARKET		
description of	.	327
effect of	.	328
justification for	.	328
method of	.	328
S		
SCRUTINEERS		
poll may be vouched for by	.	313
SEAL BOOK		
documents sealed recorded in	.	175
ruling for	.	175

## SEAL OF LIMITED COMPANY

	PAGE
contracts and . . . . .	5
debentures usually issued under . . . . .	61
first Board Meeting and approval of . . . . .	148
Lord Wrenbury's Committee and alien . . . . .	365
Minute Book should contain impress of . . . . .	148
Table " A " provisions as to . . . . .	357
two locks usually provided for . . . . .	148
share certificates <i>prima facie</i> evidence of title when issued under . . . . .	256
share warrants must be issued under . . . . .	258

## SECRET PROFITS

company may claim . . . . .	131
Corrupt Practices Act and . . . . .	131
Directors must not make . . . . .	130, 131
promoter and . . . . .	22

## SECRET RESERVES

auditor's duty in regard to . . . . .	188
how created . . . . .	188
manipulation of profits and . . . . .	188

## SECRETARY

Annual General Meeting and duty of . . . . .	303
appointment of . . . . .	148, 150
bankers would require specimen signature of . . . . .	148
duties of . . . . .	151
meetings and duty of . . . . .	306
Minute Books should be written up by . . . . .	171
registrar assists . . . . .	151
remuneration of . . . . .	148, 150

## SECURITIES

shares and stock wrongly described as . . . . .	327
Stock Exchange use of term . . . . .	327

## SERVICE OF DOCUMENTS

foreign companies and . . . . .	4
how effected . . . . .	85
post as medium of . . . . .	85
Registered Office and . . . . .	85

## SECURED CREDITORS

floating charge and . . . . .	21
-------------------------------	----

## SHARE CAPITAL

authorized or nominal . . . . .	39
cancellation of . . . . .	105, 110
classes of . . . . .	40
consolidation of . . . . .	108
conversion of shares into stock . . . . .	49, 108
co-partnership . . . . .	48
deferred or founders' . . . . .	47

## SHARE CAPITAL—(contd.)

	PAGE
definition of share . . . . .	40
differences between stock and . . . . .	50
distinctive numbers of shares comprising . . . . .	50, 381
dividends on . . . . .	52
factors to be considered in fixing form of . . . . .	52
forfeited shares and account of . . . . .	278
forfeiture of shares into stock . . . . .	105
nominal value of shares comprising . . . . .	39
notice to registrar on conversion of shares into stock . . . . .	50
ordinary . . . . .	47
preference . . . . .	40
public issue of . . . . .	192
re-organization of . . . . .	110
sub-division of . . . . .	109
surrender of . . . . .	105
Table "A" provisions as to alteration of . . . . .	352
underwriting issue of . . . . .	193

## SHARE CERTIFICATES

allotment and preparation of . . . . .	177
allotment letters exchanged for . . . . .	179
balance receipts exchanged for . . . . .	179
book kept for . . . . .	177
capital reduction and . . . . .	105
certification of transfers and records on . . . . .	270
company may rebut evidence of . . . . .	256
consolidation and division of shares and . . . . .	109
convertible preference shares and exchange of . . . . .	45
delivery of . . . . .	255
documents to be exchanged for . . . . .	255
effect of issue of . . . . .	255
estoppel operates on issue of . . . . .	256
evidence of membership contained in . . . . .	254
filing of cancelled . . . . .	273
issue of . . . . .	255
lost . . . . .	256
period allowed for preparing . . . . .	177
registration of transfers and preparation of . . . . .	177
shareholders' authority required to post . . . . .	179
Stock Exchange requirements as to . . . . .	339
sub-division of shares and . . . . .	109
Table "A" provisions as to . . . . .	347
terms of issue and period allowed for delivery of . . . . .	255
transfer receipts exchanged for . . . . .	179

## SHAREHOLDERS

affairs of company may be investigated by . . . . .	321
alteration of rights of . . . . .	100, 101
Annual List and Summary must contain particulars of . . . . .	
present and past . . . . .	172
Articles of Association form agreement between com- . . . . .	
pany and body of . . . . .	117
auditor is agent of . . . . .	152

# INDEX

437

## SHAREHOLDERS—(contd.)

	PAGE
changes of address, etc., should be notified by . . . . .	165
companies may become . . . . .	252
company not bound by signature of . . . . .	118
compromises and arrangements under Sec. 120 with . . . . .	112
condensed Balance Sheets, effect on . . . . .	185
debts are specialty debts . . . . .	99
entitled to copy of Memorandum and Articles . . . . .	90
extension of liability of . . . . .	99
fictitious persons as . . . . .	254
firms as . . . . .	253
forfeiture of shares and liability of . . . . .	277
holding companies, position of . . . . .	187
infants as . . . . .	253
individual rights and liabilities of . . . . .	261
liability of . . . . .	98
limited liability clause and . . . . .	98
married women as . . . . .	253
meetings of . . . . .	298 <i>et seq.</i>
Memorandum and variation in rights of . . . . .	101
Minutes must be kept of proceedings at meetings of . . . . .	171
notification to company of marriage of lady . . . . .	166
persons who are not . . . . .	254
reconstruction schemes and dissentient . . . . .	114
reduction of capital and rights of . . . . .	106, 107
Register of Members may be inspected by . . . . .	167
Register of Members must contain names, addresses, and occupations of . . . . .	160
right to inspect books . . . . .	10
right to receive reports and account . . . . .	10, 45 69, 75
secondary liability of persons ceasing to be . . . . .	99
taxation of dividends and . . . . .	6, 7
tax overpaid by deduction and . . . . .	9
transmission of shares of deceased . . . . .	249
— of lunatic . . . . .	252
unlimited liability of . . . . .	99
winding-up and right to petition of . . . . .	14

## SHAREHOLDERS' CASH BOOK

application and allotment sheets may do duty of . . . . .	176
cash dealings with members recorded in . . . . .	177
Journal ruling for . . . . .	177
Register of Members written up from . . . . .	162, 177

SHARE LEDGER. *See* "Register of Members."

SHARE QUALIFICATION. *See* "Qualification Shares."

## SHARES

allotment of . . . . .	236
application for . . . . .	232
bankrupt members' . . . . .	251
brokerage on . . . . .	199
calls on . . . . .	281
commission on placing . . . . .	200

SHARES—(contd.)	PAGE
cum dividend sale of . . . . .	269
deceased shareholders and transmission of . . . . .	249
definition of . . . . .	39
different classes of . . . . .	40
ex dividend sale of . . . . .	269
forfeiture of . . . . .	275
irregular allotment of . . . . .	241
lien of . . . . .	280
Lord Wrenbury's Committee and distinguishing number of . . . . .	381
lunatic members' . . . . .	252
mortgage of . . . . .	273
pool of . . . . .	193
prospectus must state particulars of shares issued other- wise than for cash . . . . .	207
surrender of . . . . .	280
Table "A" provisions as to . . . . .	347
underwriters' option to call for . . . . .	193
underwriting issue of . . . . .	193
 SHARE WARRANTS	
Annual List and Summary must state details of . . . . .	172
bad delivery of . . . . .	259
capital of company and issue of . . . . .	259
denominations of . . . . .	261
details of warrants recorded in register of . . . . .	161
dividend coupons must be attached to . . . . .	257, 259
duty payable on issue of . . . . .	259
forgery of . . . . .	259
form of . . . . .	bet. pp. 260-1
— of application for . . . . .	260
— — for registration of holder of . . . . .	261
fully-paid shares or stock included in . . . . .	257
Lord Wrenbury's Committee and . . . . .	374
private companies cannot issue or take power to issue . . . . .	261
Register of Members and issue of . . . . .	160, 258
registration of holder on surrender of . . . . .	258
seal of the company must be affixed to . . . . .	257
shareholders' names struck out of Register of Members on issue of . . . . .	161
Table "A" provisions as to . . . . .	352
transfer duty not payable on . . . . .	259
transferable by delivery . . . . .	258
 SIGNATORIES TO MEMORANDUM AND ARTICLES	
appointment of first directors by . . . . .	116
association clause contains names and descriptions of . . . . .	117
duties of . . . . .	117
Lord Lurgan's case and shares taken under misrepresen- tation by . . . . .	116
misrepresentation of promoter and . . . . .	116
promoter and right of action of . . . . .	116
shares must be stated in association clause . . . . .	117
signatory shares may be held as nominees by . . . . .	116

# SOLICITORS

	PAGE
appointment of . . . . .	148
prospectus should be drafted by counsel and . . . . .	202

# SPECIAL PROXY

definition of . . . . .	314
stamp duty on . . . . .	314
<i>Also see "Proxies."</i>	

# SPECIAL RESOLUTION

accumulated profits returned to shareholders in reduction of paid-up capital requires . . . . .	105
alteration of Articles requires . . . . .	120
alteration of Objects Clause in Memorandum and . . . . .	97
Articles and . . . . .	319
business requiring a . . . . .	318
confirmatory meeting and effect on . . . . .	318
definition of . . . . .	317
Directors' liability may be made unlimited by . . . . .	99
extraordinary resolution compared with . . . . .	317
filing of . . . . .	319
increase of capital may require . . . . .	101
meetings necessary for passing . . . . .	317
name of company with sanction of Board of Trade may be altered by . . . . .	94
Objects Clause of Memorandum, with sanction of Court, may in certain cases be altered by . . . . .	97
petition for winding-up and . . . . .	14, 15
reduction of capital may require two . . . . .	103
sub-division of shares requires . . . . .	109

# SPECIFIC PERFORMANCE

agreement to take shares or debentures may be enforced by an order for . . . . .	77, 237
allotment of shares or debentures may be enforced by order for . . . . .	77, 237

# STAGS

definition of . . . . .	242
object of eliminating . . . . .	242
over-subscription and elimination of . . . . .	242

# STAMP DUTIES AND FEES

Allotment Letter and . . . . .	238
Articles of Association and . . . . .	119
debentures and . . . . .	78
Inland Revenue concession as to duty payable on increase of capital . . . . .	101
letter of indemnity and . . . . .	257
Power of Attorney and . . . . .	264
proxies and . . . . .	314
reduction of capital and non-return of . . . . .	102
registration and . . . . .	84
share warrants and . . . . .	259
transfer of shares and . . . . .	265



## STATEMENT IN FORM OF BALANCE SHEET

	PAGE
Annual List and Summary must contain a . . . . .	173
assets should not be bulked in . . . . .	174
auditors must audit the . . . . .	157
date of . . . . .	174
foreign companies and . . . . .	4
liabilities should be distinguished in . . . . .	174
private companies and . . . . .	10, 174
Profit and Loss Account balance need not be shown in . . . . .	174

## STATEMENT IN LIEU OF PROSPECTUS

Balance Sheets and . . . . .	228
commencement of business and filing of . . . . .	88
contents of Memorandum of Association need not be included in . . . . .	228
differences between prospectus and . . . . .	228
form and contents of . . . . .	229
liabilities of signatories of . . . . .	228
private companies need not file . . . . .	11, 231
public companies and . . . . .	88, 227
trading certificate and filing of . . . . .	88
underwriting commission must be stated in . . . . .	195

## STATUTORY DECLARATION

commencement of business and filing of . . . . .	88
registration of company and filing of . . . . .	84

## STATUTORY MEETING

check on directors afforded by . . . . .	150
companies limited by shares must hold . . . . .	298
company liable to be wound up if it does not hold . . . . .	300
conduct of promotion may be inquired into at . . . . .	299
list of members to be open for inspection at . . . . .	299
object of holding . . . . .	299
period provided for holding . . . . .	298
private as well as public companies must hold . . . . .	299
— companies and . . . . .	10, 299
public companies and . . . . .	299
resolutions which may be passed at . . . . .	299
shareholders' right of discussion at . . . . .	299
Statutory Report must be submitted at . . . . .	300

## STATUTORY REPORT

auditors must certify part of the . . . . .	157, 302
directors must certify . . . . .	301
filing of copy of . . . . .	303
form of . . . . .	301
particulars to be contained in . . . . .	300
preliminary expenses and . . . . .	24
private companies and . . . . .	10, 300
public companies and . . . . .	300

## STOCK

Articles of Association and . . . . .	49
conversion of shares into . . . . .	49

## STOCK—(contd.)

	PAGE
differences between shares and . . . . .	50
financial records on conversion of shares into . . . . .	50
must be fully paid . . . . .	50, 109
no distinctive numbers on . . . . .	50
notice to Registrar of conversion of shares into . . . . .	50
—— — of reconversion of stock into shares . . . . .	50
re-conversion of stock into shares . . . . .	50
Register of Members and . . . . .	50, 160
transfer of . . . . .	50, 51

## STOCKBROKERS

act as agents . . . . .	325
appointment of . . . . .	148
certification of transfers and . . . . .	269
collection of dividends by . . . . .	269
commission payable to . . . . .	328
influence of name of . . . . .	192
method of dealing by . . . . .	331
promoter and . . . . .	25
sharing of commissions by . . . . .	327

## STOCK EXCHANGE

application for official quotation on . . . . .	337
Articles of Association and . . . . .	338
certified transfers accepted as good delivery by . . . . .	264
constitution of . . . . .	325
dealing on . . . . .	331
defaulters on . . . . .	326
deputy official assignee . . . . .	326
Directors' power to refuse transfers and attitude of . . . . .	262
documents to be produced to secretary of share and loan . . . . .	
department of . . . . .	335
hammering on . . . . .	326
influence of . . . . .	327
investors and the . . . . .	329
lien on shares and rules of . . . . .	280
management vested in committee of . . . . .	326
members of . . . . .	325
offers for sale and beneficial influence of rules of . . . . .	202
official assignee of . . . . .	326
permission to deal on . . . . .	335
Prospectus and application for an official quotation . . . . .	214
rigging of market on . . . . .	327
rules of . . . . .	335
settlements on . . . . .	334
stockbroker's name and . . . . .	192
sub-markets of . . . . .	325

## STOCK IN TRADE

auditors not valuers of . . . . .	156
Balance Sheet and . . . . .	187
promoter and . . . . .	25
valuation of . . . . .	31

STOCK JOBBERS		PAGE
act as principals . . . . .		325
method of dealing with . . . . .		332
price need not be made by . . . . .		332
rigging markets and . . . . .		328
stockbrokers deal with . . . . .		325
SUB-DIVISION OF SHARES		
illegal before passing of Companies Act, 1908 . . . . .		109
liability on original shares must not be affected by . . . . .		109
special resolution required for . . . . .		109
SUBSCRIBED OR ISSUED CAPITAL		
definition of . . . . .		55
SUBSIDIARY COMPANIES		
controlling interest of holding companies in . . . . .		189
Directors of holding companies represented on boards of . . . . .		189
SUPER-TAX. See "Taxation of Limited Companies."		
SURRENDER OF SHARES		
Articles of Association and . . . . .		280
forfeiture and the right to . . . . .		280
power of directors to accept . . . . .		280

## T

## TABLE "A"

accounts of company and . . . . .	360
alteration of capital and . . . . .	352
applies where not expressly excluded by company's Articles . . . . .	118
audit and . . . . .	360
Balance Sheets must be prepared under . . . . .	154
Board Meetings and fixing of quorum under . . . . .	146
Board of Trade may revise . . . . .	119
calculation of dividends under . . . . .	42
calls on shares and . . . . .	348
conversion of shares into stock and . . . . .	351
Directors must each hold one share under . . . . .	122
Directors must hold at least one share in companies adopting . . . . .	122
disqualification of directors and . . . . .	139, 357
dividends and reserves and . . . . .	359
forfeiture of shares and . . . . .	276, 350
General Meetings and . . . . .	353
increase of capital and . . . . .	101
lien on shares and . . . . .	348
notices to members and . . . . .	360
powers and duties of directors and . . . . .	356
proceedings of directors and . . . . .	358
public companies without Articles must work under . . . . .	118
qualification shares not provided for in . . . . .	136

TABLE "A"—(contd.)

	PAGE
removal of director requires extraordinary resolution under . . . . .	140
rotation of directors and . . . . .	357
seal of company and . . . . .	357
share warrants and . . . . .	352
shares and . . . . .	347
transfer and transmission of shares and . . . . .	349
votes of members and . . . . .	355

## TAXATION

allowances to individuals and . . . . .	6
bonus share issue and . . . . .	296, 297
Corporation Profits Tax . . . . .	6
deduction of tax from dividends . . . . .	6
dividend warrant as voucher for payment of . . . . .	292
— — — — must show . . . . .	293
earned income allowance and . . . . .	6
Finance Act, 1922, and . . . . .	7
— — — — 1924, and . . . . .	7
formula for finding gross dividend . . . . .	6
income tax . . . . .	6
— — — — payable in one amount . . . . .	8
incorporation and adjustment of . . . . .	86
liability to super-tax . . . . .	6
particulars on dividend warrants . . . . .	6
payment of dividends and apportionment of . . . . .	290
profits for prospectus purposes and . . . . .	33
promoter's profit and . . . . .	26
rate relief and . . . . .	6
remuneration of directors and . . . . .	134
valuation of assets and . . . . .	36
withholding profits from distribution and . . . . .	7

## TRADING AND PROFIT AND LOSS ACCOUNT

accountant for investigation purposes should tabulate . . . . .	30
financial books should be organized to facilitate preparation of . . . . .	184

## TRADING CERTIFICATE

bankers require to inspect . . . . .	148
commencement of business and . . . . .	88, 89
conclusive evidence of . . . . .	89
Directors shares and . . . . .	88
form of . . . . .	89
issued by Registrar of Joint Stock Companies . . . . .	89

## TRANSFER OF SHARES OR DEBENTURES

administrators' right to . . . . .	249
<i>ad valorem</i> stamp duties and fees on . . . . .	265
Annual List and Summary and . . . . .	172
Articles of Association provide rules for . . . . .	119
compulsory winding-up and . . . . .	263
conditions endorsed on debenture as to . . . . .	69

## TRANSFER OF SHARES OR DEBENTURES—(contd)

	PAGE
contract stamps on . . . . .	266
directors' power to refuse to assign reasons for refusing a . . . . .	262
effect of delivery of certified . . . . .	264
execution of . . . . .	264
executors right to . . . . .	249
forged . . . . .	267
Forged Transfers Acts and . . . . .	267
form of . . . . .	bet. pp. 264-5
joint holders and . . . . .	264
Judicature Act, 1873, and . . . . .	263
liability of parties to . . . . .	268
members' common law right to transfer . . . . .	10
members' statutory right to . . . . .	262
membership and . . . . .	248
nominal duty payable in certain cases on . . . . .	265
notice of meetings and . . . . .	308
oral . . . . .	262
partnerships and . . . . .	10
Power of Attorney and signature of . . . . .	264
rectification of register and oral . . . . .	264
registration fee payable on . . . . .	186
restrictions on . . . . .	262
right of parties to dividends . . . . .	268
special form of . . . . .	bet. pp. 264-5
Stock Exchange and directors' power to refuse . . . . .	262
Table "A" provisions as to . . . . .	349
to paupers as a gift . . . . .	99
transferee's liability on . . . . .	98
transferor's liability on . . . . .	98
trustee in bankruptcy and . . . . .	251
voluntary winding-up and . . . . .	263
winding-up and . . . . .	16, 263

## TRANSFEE

<i>ad valorem</i> duties payable by . . . . .	266
cum dividend purchase of shares and rights of . . . . .	269
ex dividend purchase of shares and rights of . . . . .	269
execution of transfer by . . . . .	264
forged transfer gives no right to be placed on register to . . . . .	267
— — — gives no right to action for damages against . . . . .	267
company to . . . . .	267
implied contract of indemnity . . . . .	268
liability as member does not commence until transfer . . . . .	268
registered . . . . .	98
liability of . . . . .	308
notice of meetings and . . . . .	266
registration fee payable by . . . . .	

## TRANSFER FEES BOOK

company with outside registrar need not keep . . . . .	182
ruling for . . . . .	182

## TRANSFER FEES

	PAGE
accountant registrar and . . . . .	182
book in which to record . . . . .	182
Profit and Loss Account and . . . . .	183

## TRANSFER OFFICE

accountant's office as . . . . .	167
certification of transfers and routine of . . . . .	269
register of members and disorganization of . . . . .	160
— — — may be kept at . . . . .	167
registration of transfers and procedure of . . . . .	271

## TRANSFEROR

cum dividend sales of shares and rights of . . . . .	269
ex dividend sale of shares and rights of . . . . .	269
execution of transfer by . . . . .	264
form of letter to . . . . .	179, 180
liability of . . . . .	98
List " B " contributories and . . . . .	99, 268
notice of meetings and . . . . .	308
— of transfers lodged sent to . . . . .	179
registration of transfer relieves from liability as member	268
transferee impliedly contracts to indemnify the . . . . .	268

## TRANSFER RECEIPT

book kept for dealing with . . . . .	180
certification of transfers against . . . . .	271
form of . . . . .	180, 181
share certificate issued in exchange for . . . . .	179

## TRANSMISSION OF SHARES

Articles of Association and . . . . .	248
deceased's estate and . . . . .	250
evidence of title and . . . . .	252
executor or administrator may deal with shares on . . . . .	249
letter of request to be registered on . . . . .	250
Letters of Administration and . . . . .	249
liability of persons registered on . . . . .	249
liquidation of member and company . . . . .	252
lunatic members and . . . . .	252
membership and . . . . .	248
method of transferring shares on . . . . .	250
probate and . . . . .	249
proof of title by person claiming by . . . . .	249
Register of Members and . . . . .	249
shares of deceased members and . . . . .	249
Table " A " provisions as to . . . . .	349
transfer of shares distinguished from . . . . .	249
trustee in bankruptcy and . . . . .	251

## TRUST DEEDS

advantages of . . . . .	70
debenture holders' right to copies of . . . . .	75
duties of the trustee under . . . . .	70, 71

<b>TRUST DEEDS—(contd.)</b>		<b>PAGE</b>
inspection of . . . . .		75
powers of trustees under . . . . .		70
rules of Stock Exchange and . . . . .		70
Stock Exchange requirements as to . . . . .		339
<b>TRUSTEE IN BANKRUPTCY</b>		
Bankruptcy Acts and powers of . . . . .		251
right of disclaimer possessed by . . . . .		251
shares of bankrupt members vest in . . . . .		251
transfer of shares of bankrupt can only be effected by . . . . .		251
<b>TRUSTEES FOR DEBENTURE OR DEBENTURE STOCK HOLDERS</b>		
agents may be employed by . . . . .		71
appointment of attorneys by . . . . .		71
conflict of interest and . . . . .		71
contract usually made with . . . . .		63
delegation of authority by . . . . .		71
duties of . . . . .		71
joint action necessary by . . . . .		71
registration of debenture by . . . . .		71
Trust Deeds and . . . . .		70
<b>TRUSTEES</b>		
company cannot take cognizance of representative capacity of . . . . .		162
debenture holders may appoint . . . . .		63
directors as . . . . .		127
liability of persons holding shares as . . . . .		164
registration should be effected in names of . . . . .		164
<b>TRUSTS</b>		
Register of Members not to contain notice of . . . . .		162
<b>TURNOVER</b>		
bad debts and . . . . .		34
for prospectus purposes . . . . .		31, 34
house transactions and . . . . .		34
profits prior to incorporation adjusted on basis of . . . . .		86
returns and allowances and . . . . .		34
trade discounts and . . . . .		34
<b>U</b>		
<b>UNCALLED CAPITAL</b>		
definition of . . . . .		55
<b>UNCLAIMED DIVIDENDS</b>		
Balance Sheet and . . . . .		165
forfeiture of . . . . .		286
shareholders' failure to notify changes accounts for . . . . .		
large balances under heading of . . . . .		165
trade creditors should not include . . . . .		187

## UNDERWRITERS

	PAGE
application forms of . . . . .	198
commission payable to . . . . .	193
definition of . . . . .	193
liability of . . . . .	193
nominees of . . . . .	195
option to call for shares may be given to . . . . .	193
over-riding commissions and . . . . .	194
over-subscription of issue and . . . . .	193
pool may be formed by . . . . .	194
sub-underwriting relieves . . . . .	194
under-subscription of issue and . . . . .	193

## UNDERWRITING

commission payable for . . . . .	193
consideration for . . . . .	193
contract of . . . . .	195
definition of . . . . .	193
firm applications and . . . . .	193
letter of . . . . .	195
nature of . . . . .	193
option to call for shares as consideration for . . . . .	193
over-riding commission and . . . . .	194
pool of shares and . . . . .	193
reduction of liability for . . . . .	193
relief of underwriters by sub- . . . . .	194
underwriter's application forms should be marked . . . . .	198

## UNDERWRITING COMMISSION

Articles must authorize payment of . . . . .	198
Balance Sheet must show amount of . . . . .	199
definition of . . . . .	194
issue of shares at discount and . . . . .	198, 200
prospectus must state amount or rate of . . . . .	198
provisions of Sec. 89 of Act as to . . . . .	198
statement in lieu of prospectus must state amount or rate of . . . . .	198
underwriter's liability and application of . . . . .	197

## UNDERWRITING LETTER

application forms should accompany . . . . .	198
form of . . . . .	196
nature of . . . . .	195
signature of agents on . . . . .	196
stamp on . . . . .	195

## UNDER-SUBSCRIPTION

allotment on . . . . .	243
bank loan may be necessary on . . . . .	243
creation of market on . . . . .	244
return of application moneys on . . . . .	244
underwriting applications and . . . . .	243
underwriter's cheques and . . . . .	243



## UNLIMITED LIABILITY

PAGE

companies may be registered with . . . . .	2, 98
defunct companies and . . . . .	18
directors may have . . . . .	99
illegal associations and . . . . .	3
members may have . . . . .	2, 3, 99
— of firms have . . . . .	9

## " ULTRA VIRES " ACT

shareholders and directors . . . . .	96, 97
--------------------------------------	--------

## V

## VALUATION OF ASSETS

taxation and . . . . .	36
valuers and . . . . .	35

## VALUATION OF SHARES

creditors and . . . . .	215
loanable capital and . . . . .	215
net assets as basis of . . . . .	215
yield and adjustment of net assets . . . . .	51, 216

## VALUERS' REPORTS

armchair valuers and . . . . .	35
assets should be separately valued in . . . . .	35
effect of over-valuation in . . . . .	35
method of valuation for . . . . .	35

## VENDORS

definition of . . . . .	207
members of firms not to be treated as separate . . . . .	207
prospectus must give particulars of . . . . .	207
Stock Exchange requirements as to shares of . . . . .	344

## VOTING POWERS

demand of a poll . . . . .	312
loanable capital and holder's . . . . .	56
member company and exercise of . . . . .	312
methods of using . . . . .	312
nominal value of shares no indication of . . . . .	312
preference shareholders and . . . . .	46
prospectus must state . . . . .	211
provisions of Act as to . . . . .	311
proxies cannot be used on vote or show of hands . . . . .	312
statement in lieu of prospectus must state . . . . .	228
Table " A " provisions as to . . . . .	355

## W

## WASTING ASSETS

definition of . . . . .	287
profits available for dividend and depreciation of . . . . .	287

## WINDING-UP

	PAGE
contributories and . . . . .	14
creditors and . . . . .	14
courts having jurisdiction . . . . .	16
date company ceases to exist on . . . . .	16
effect of voluntary . . . . .	15
extraordinary resolution and . . . . .	15
failure to hold statutory meeting and . . . . .	300
forfeiture of shares in . . . . .	277
grounds for . . . . .	11
liquidators appointed for purpose of . . . . .	12
main object of company and . . . . .	97
mode of . . . . .	11
number of members below minimum . . . . .	3
order for payment of creditors in . . . . .	12
ordinary resolution and . . . . .	15
original allottees and . . . . .	14
preferential creditors . . . . .	12
proceedings for negligence in . . . . .	27, 142
rectification of Register of Members may be ordered in . . . . .	165
removal of defunct company from register . . . . .	17
remuneration of directors has no preference in . . . . .	133
right to inspect Register of Members ceases on . . . . .	168
rights of holders of preference shares in . . . . .	43
special resolution and . . . . .	14, 15
transfer of shares in . . . . .	263
voluntary . . . . .	15
who may petition for . . . . .	14

## WORKING CAPITAL

capitalization of company and . . . . .	38
definition of . . . . .	56
public issue of capital and . . . . .	216



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